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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No. 265

FEDERAL POWER COMMISSION AND ILLINOIS COMMERCE COMMISSION,

Petitioners,

vs.

NATURAL GAS PIPELINE COMPANY OF AMERICA AND TEXOMA NATURAL GAS COMPANY,

Respondents.

No. 268

NATURAL GAS PIPELINE COMPANY OF AMERICA AND TEXOMA NATURAL GAS COMPANY,

Petitioners,

vs.

FEDERAL POWER COMMISSION AND ILLINOIS COMMERCE COMMISSION,

Respondents.

BRIEF FOR NATURAL GAS PIPELINE COMPANY OF AMERICA AND TEXOMA NATURAL GAS COMPANY.

GEORGE I. HAIGHT,
209 South La Salle St., Chicago, Ill.
J. J. HEDRICK,
20 North Wacker Drive, Chicago, Ill.
WILLIAM E. LUCAS,
209 South La Salle St., Chicago, Ill.
S. A. L. MORGAN,
20 North Wacker Drive, Chicago, Ill.
Attorneys for Natural Gas Pipeline Company of America and Texoma Natural Gas Company.

HAIGHT, GOLDSTEIN & HOBBS,
209 S. La Salle St.,
Chicago, Ill.
MORGAN, CULTON, MORGAN & BRITAIN,
Amarillo, Texas,
Of Counsel.

THE CONSOLIDATED-HARMON PRINTING COMPANY, 209 WEST JACKSON, CHICAGO

SUBJECT INDEX.

	PAGE
INTRODUCTION	1
Opinions Below	2
Jurisdiction	2
Statute Involved	2
Statement of the Case	2
Cross-Petitioners' Business	3
Proceedings Before the Commission	4
The Commission's Order and Opinion	5
The Rate Base	6
Rate of Return	8
Amount to Be Amortized	8
Amortization Period	9
Interest on Sinking Fund	9
Commission's Conclusion	10
Commission's Failure to Fix Rates	10
The Judgment and Opinion of the Circuit Court of Appeals	11
THE EVIDENCE	13
Origin of the Enterprise	13
Cross-Petitioners' Properties	15
Cross-Petitioners' Marketing Contracts	20
The Load Building Period	21
Cross-Petitioners' Gas Reserves	25

Capital Additions to Cross-Petitioners' Properties and Replacement, Maintenance and Operating Expenses 27
Future Revenues of Petitioners 29
Reproduction Cost New of Cross-Petitioners' Property 31
Interest on Sinking Fund for Amortization 32
Return on Investment Over Entire Life of Properties 33
Exhibits Summarizing Revenues, Costs, etc., of Cross-Petitioners 34
Evidence Relating to Rate of Return 36
1. The Danger of Failure in the Supply of Gas 37
2. The Danger of Increased Costs 37
3. Dangers Incident to Employment of High Pressures and High Stresses 38
4. Danger of Pipeline Failure 39
5. Danger That Another Source of Supply Nearer to Cross-Petitioners' Market May Be Discovered 39
6. Danger of Competition With Other Fuels. 40
7. Danger of Increased Taxes and of Punitive Legislation 41
8. Danger of Increasing Costs of Regulation. 43
9. Danger of Inflation 44
10. Danger of Varying Demand 45
Evidence on Risks Offered by Complainant and the Commission 46

SPECIFICATION OF ERRORS 49

SUMMARY OF ARGUMENT 52

ARGUMENT 68

I. The Court Below Correctly Held That the Commission's Order Should Be Set Aside Because It Is Confiscatory in That the Commission Disregarded Going Concern Value in Fixing the Rate Base and the Amount to Be Amortized 68

A. The Commission erred in refusing to allow Cross-Petitioners' claim of $8,500,000 as going concern value 68

B. In any event, the Commission erred in refusing to allow any going concern value .. 68

II. The Court Below Correctly Held That the Commission's Order Should Be Set Aside Because It Is Confiscatory in That the Commission Provided for the Amortization of Only the Original Cost of the Property and Fixed the Amortization Period at the Entire Life of Cross-Petitioners' Business, Which Commenced Long Prior to Regulation 102

A. The necessary operation and effect of the Natural Gas Act, if valid, is to condemn to public use cross-petitioners' property utilized in the conduct of their business, which, prior to the enactment of the Act, was a strictly private business 102

B. A valid administration of the Natural Gas Act requires that cross-petitioners be compensated by a proper amortization allowance for the present fair value of their properties, including going concern value, as of the time they were condemned for public use 102

C. The proper period of amortization is that beginning with regulation under the Natural Gas Act and ending with the life of cross-petitioners' enterprise 102

III. While the Court Below Did Not Pass on the Question, the Commission's Order Should Be Set Aside on the Ground That It Is Confiscatory in That, in Computing the Annual Allowance for Amortization by the Sinking Fund Method, the Commission Charged Cross-Petitioners Compound Interest on the Annual Installments at the Rate of 6½% Per Annum. 130

A. In providing for amortization the Commission was required to allow annual installments for accruals out of earnings which, added together, will return the proper amount to be amortized by the time cross-petitioners' reserves of gas are exhausted. 130

B. Under the sinking fund method adopted by the Commission in computing the annual allowance, the interest rate used in the computation, under the uncontradicted testimony, must be no higher than 2% per annum compounded semi-annually 130

IV. A. While the Court Below Did Not Expressly Pass on the Question, the Commission's Order Should Be Set Aside on the Ground That There Is No Substantial Evidence to Support the Commission's Finding That Cross-Petitioners' Present Charges Are Unjust and Unreasonable 145

B. If by Implication It Overruled Cross-Petitioners' Contention on This Point, the Court Below Erred in Not Sustainting Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because There Is No Substantial Evidence to Support the Commission's Finding That Cross-Petitioners' Present Charges Are Unjust and Unreasonable 145

V. The Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because the Commission Did Not Fix New Rates as Required by the Natural Gas Act..... 166

IV. The Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because It Is Confiscatory in That It Denies Cross-Petitioners a Fair Rate of Return..... 175

A. There is no substantial evidence to support the finding of the Commission that 6½% per annum on the rate base allowed by the Commission is a fair rate of return for cross-petitioners 175

B. Under the evidence submitted by cross-petitioners, which is uncontradicted by any substantial evidence, cross-petitioners are entitled to a rate of return on the rate base claimed by them of not less than 8% per annum 175

The Witnesses for Cross-Petitioners on Rate of Return 185

The testimony of Delafield..... 185

The testimony of Emery..... 187

The testimony of Gilman 190

The testimony of Dorau..... 192

The Witnesses for the Commission and Complainant on Rate of Return..... 195

The testimony of Knapp..... 196

The testimony of Ostrander..... 197

The testimony of Kleinman..... 199

The testimony of Smith..... 204

VII. The Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because the Commission Is Without Power and Jurisdiction to Enter an Interim Order..... 216

A. The power and jurisdiction of the Commission to fix charges for natural gas are derived solely from the Natural Gas Act.. 216

B. By the enactment of the Natural Gas Act, Congress neither conferred nor intended to confer on the Commission power and jurisdiction to enter an interim order in the midst of the hearing..... 216

C. The order entered by the Commission under the assumption that it had power and jurisdiction under the Natural Gas Act to enter an interim order is void..... 216

VIII. The Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because the Natural Gas Act as Applied by the Commission to Cross-Petitioners' Business Is in Conflict With the Fifth Amendment to the Constitution of the United States..... 234

A. The regulation imposed is violative of the Fifth Amendment because cross-petitioners' business is not affected with a public interest and is not subject to a price regulation 234

B. The regulation imposed is violative of the Fifth Amendment because it involves a taking of the use of cross-petitioners' property for the public and prohibits cross-petitioners from withdrawing their property from such use except by permission of the Commission 249

IX. The Court Below Correctly Held, in Effect, That the Holding of the Commission That $6,395,180 Per Annum Is an Adequate Allowance to Cross-Petitioners for Amortization and Return Is Not Supported by Substantial Evidence and Is Contrary to the Law Applicable to Such Allowances 254

X. The Court Below Correctly Held, in Effect, That the Holding and Finding of the Commission That Cross-Petitioners' Annual Net Revenues Available for Amortization and Return Exceed the Amount Reasonably Necessary by $2,966,852 and That a Reduction in Cross-Petitioners' Annual Revenues of the Amount Last Stated, Together With the Consequent Reduction in the Applicable Federal Income Taxes, Would Permit a Reduction in Net Operating Revenues of $3,750,000 Annually, Are Not Supported by Substantial Evidence and Are Contrary to the Law Applicable to the Fixing of Proper Allowances for Cross-Petitioners 254

XI. The Court Below Correctly Held, in Effect, That the Holding of the Commission That the Rates and Charges of Cross-Petitioners, After Reflecting the Reduction Ordered, Will Be Just and Reasonable Is Not Supported by Substantial Evidence 255

XII. The Commission's Order, as Modified, Directing Cross-Petitioners, on or Before September 1, 1940, to File New Schedules of Rates and Charges for the Sale of Gas Which Shall Reflect a Reduction in Cross-Petitioners' Operating Revenues of Not Less Than $3,750,000 Per Annum, If Enforced, Would Result in Confiscation of Cross-Petitioners' Property and Revenues, in Violation of the Due Process Clause of the Fifth Amendment to the Constitution of the United States 255

Summary 255

A. Going concern value 255

B. Amortization 256

(1) The period of amortization 256

(2) The interest rate in computing the annual amount 256

(3) The combined result of the errors in fixing the annual allowance for amortization 257

C. Rate of Return 258

D. Jurisdiction 258

(1) The present rates 258

(2) The failure of the Commission to fix new rates 259

(3) The power to issue an interim order .. 259

(4) The question of constitutionality 259

XIII. If This Court Should Reverse the Judgment of the Court Below and Uphold the Commission's Order, Cross-Petitioners Should Not Be Required to Refund to Their Customers the Amounts Representing the Ordered Reduction in Revenues Which Have Accrued Since the Commission's Order 260

A. No public interest will be served by requiring cross-petitioners to pay over as a windfall to their wholesale customers the very substantial sums of money involved in such a refund, which amounts the distributing utilities contracted to pay cross-petitioners and which, if refunded to them, such distributing utilities could not be required by state regulatory bodies to pass on to their customers, the consumers.... 260

B. The existing rates are valid and enforcible until the Commission shall determine the just and reasonable rates and fix the same by order; and even if the court below should have held that the Commission could require cross-petitioners to file new schedules of rates effecting the reduction ordered, such new rates could not be made retroactive, but would become effective only when constituted the new rates by order of the Commission 260

Conclusion 264

Appendix A—Pertinent sections of the Natural Gas Act 267

Appendix B—Summary sheet of Exhibit 140 274

Appendix C—Exhibit 210 275

Appendix D—Exhibit 211 276

CASES CITED.

Adams Express Co. v. Ohio State Auditor, 166 U. S. 185 89

Akron C. & Y. Co. v. U. S., 261 U. S. 184 224

Alexandria Water Co. v. City Council of Alexandria, 177 S. E. 454, 163 Va. 512 114-15

Ames v. Union Pacific Ry. Co., 64 Fed. 165 112

Re Baker Natural Gas Utility, P. U. R. 1921E, 609 181

Banton v. Belt Line Corp., 268 U. S. 413 ..... 150, 172

Beaver Valley Water Co. v. Driscoll, 28 Fed. Supp. 722 232

Berg v. N. Y., etc., Ry. Co., P. U. R. 1933D, 462 233

Block v. Hirsch, 256 U. S. 135 251

Bluefield W. W. & I. Co. v. Public Service Commission, 262 U. S. 679 ..... 63, 177

Bogart v. Wisconsin Tel. Co., P. U. R. 1916C, 1020 143

Brooks-Scanlon Corp. v. U. S., 265 U. S. 106 ..... 110, 116

Bronx G. & E. Co. v. Maltbie, 3 N. E. (2) 512 232

Canada Southern R. Co. v. International Bridge Co., P. R. App. Cas. 723 151

Cary v. Corporation Commission, 17 Fed. Supp. 772 .. 180

Central Ky. Natural Gas Co. v. Railroad Commission, 60 Fed. (2) 137 141

Cheltenham & Abington Sewerage Co. v. Public Service Commission, 122 Pa. Sup. 252; 186 Atl. 149 ..... 59, 139

C. I. & L. Ry. Co. v. International Milling Co., 43 Fed. (2) 93 ..... 148, 264

C. N. O. & T. P. Ry. Co. v. I. C. C., 162 U. S. 184 217-18

Citizens Gas Co. of Hannibal v. Public Service Commission, 8 Fed. (2) 632 92

City of Cincinnati v. Public Utilities Commission, 117 N. E. 381 231
City of Fort Smith v. Southwestern Bell Tel. Co., 270 U. S. 627 ..... 55, 74, 87
City of Minneapolis v. Rand, 285 Fed. 818 262
Clark's Ferry Bridge Co. v. Public Service Commission, 291 U. S. 277 142
Cleveland G. C. & St. P. Ry. Co. v. Backus, 154 U. S. 439 88
Columbus Gas & Fuel Co. v. Public Utilities Commission, 292 U. S. 398 ..... 74, 97-8
Commissioner v. Adams, 54 Fed. (2) 228 225
Re Coos & Curry Tel. Co., P. U. R. 1924E, 344 143
Cotting v. Godard, 183 U. S. 79 ..... 151, 152-3, 158, 164
Covington & Lexington Turnpike Co. v. Sandford, 164 U. S. 578 122
Dayton P. & L. Co. v. Public Utilities Commission, 292 U. S. 290 97
Dept. Public Works v. Pacific Co. Bridge Co., P. U. R. 1928D, 278 142-3
Des Moines Gas Co. v. Des Moines, 238 U. S. 153 ..... 55, 91, 94
Driscoll v. Edison L. & P. Co., 307 U. S. 104 232
East Bakersfield Imp. Assoc. v. San Joaquin L. & P. Co., P. U. R. 1916C, 830 140
Federal Trade Commission v. Raladam Co., 283 U. S. 643 225
Galveston Electric Co. v. Galveston, 258 U. S. 388 ..... 74, 84, 163, 232, 262
Gloucester Water Supply Co. v. City of Gloucester, 60 N. E. 977, 179 Mass. 365 90
Re Golden Gate Ferry Co., P. U. R. 1927A, 525 140

Re Great Western Power, P. U. R. 1923C, 545..... 142
Humphrey, Exr. v. U. S., 295 U. S. 602..... 225
I. C. C. v. C. N. O. & T. P. Ry. Co., 167 U. S. 479..... 218
I. C. C. v. L. & N. R. R. Co., 227 U. S. 88.....65, 142, 220
I. C. C. v. U. P. Ry. Co., 222 U. S. 541..... 164
Kaul v. American, etc., Tel. Co., 147 Pac. 1130, 95 Kan. 1..... 147
Kennebec Water Dist. v. Waterville, 54 Atl. 6, 97 Me. 185..... 90
Knoxville v. Knoxville Water Co., 212 U. S. 1..... 262
Landon v. Public Utilities Commission, 242 Fed. 658... 179
Lansdown v. Faris, 66 Fed. (2) 939..... 225
Leighton Chamber of Commerce v. Leighton Water Sup. Co., P. U. R. 1930D, 198..... 143
Lincoln G. & R. L. Co. v. Lincoln, 250 U. S. 256..... 92
Lindheimer v. Illinois Bell Tel. Co., 292 U. S. 151.... 114
Re Los Angeles Gas & Electric Corp., P. U. R. 1922A, 283..... 140
Los Angeles G. & E. Co. v. Railroad Commission, 289 U. S. 287.....95-6, 172
L. & N. R. R. Co. v. Commission, 195 Fed. 541.....147-8
L. & N. R. R. Co. v. U. S., 238 U. S. 1..... 164
Manhattan Properties v. Irving Trust Co., 291 U. S. 320 226
McCardle v. Indianapolis Water Co., 272 U. S. 400...55, 92
Michigan Public Utilities Comm. v. Duke, 266 U. S. 570.....237-8
Mississippi River Fuel Corp. v. Federal Power Commission, 121 Fed. (2) 159..... 261
Missouri ex rel. S. W. Bell Tel. Co. v. Public Service Comm., 262 U. S. 276.....62, 63, 154, 171-2, 177, 184
Mobile Gas Co. v. Patterson, 293 Fed. 208..... 92

Monahan v. Pacific G. & E. Co., P. U. R. 1916B, 609.... 140
Monongahela Navigation Co. v. U. S., 148 U. S. 312... 111
Monroe Gas Light & Fuel Co. v. Michigan Public Utilities Comm., 11 Fed. (2) 319..... 92
Municipal Gas Co. v. City of Sherman, P. U. R. 1925E, 67..... 182
Munn v. Illinois, 94 U. S. 113.....240, 241
National Labor Relations Board v. Abell Co., 97 Fed. (2) 951.....61, 100
National Water Works v. Kansas City, 62 Fed. 853.....89, 116-17
Nebbia v. New York, 291 U. S. 502...241, 242, 247, 248, 249
Newburyport Water Co. v. Newburyport, 47 N. E. 533, 168 Mass. 541..... 90
New State Ice Co. v. Liebmann, 285 U. S. 262.....66, 239, 242, 248
New York v. New York Telephone Co., 189 N. Y. Sup. 701..... 230
New York & Richmond Gas Co. v. Prendergast, 10 Fed. (2) 167..... 92
Ohio Bell Tel. Co. v. Public Service Commission, 301 U. S. 292.....65, 220-1
Oklahoma Natural Gas Co. v. Corporation Commission, 216 Pac. 917..... 181
Olsen v. Nebraska, 85 L. Ed. 820..... 242
Omaha v. Omaha Water Co., 218 U. S. 180.....55, 90
Re Pierce County Tel. Co., P. U. R. 1919F, 92..... 143
Pioneer T. & T. Co. v. Westenhaver, 118 Pac. 354, 29 Okla, 429..... 93-4
Re Portland R. Light & P. Co., P. U. R. 1916D, 976... 143
Producers Transportation Co. v. Railroad Commission, 251 U. S. 228..... 238

Public Service Co. v. Board of Utility Commissioners, 84 N. J. L. 463, 94 Atl. 634 ..... 149-150, 151
San Anselmo v. Marin Water & Power Co., P. U. R. 1916F, 782 142
San Diego Land & Town Co. v. National City, 74 Fed. 79 111
Siler v. L. & N. Co., 213 U. S. 175 217
Smyth v. Ames, 169 U. S. 466 123
Re Southern California Gas Co., P. U. R. 1922A, 277 140-182
Re Southern Counties Gas Co., P. U. R. 1921B, 705 140
Re Southern Counties Gas Co., P. U. R. 1921E, 374 140
Southwestern Bell Tel. Co. v. City of Fort Smith, 294 Fed. 102 ..... 55, 84-6
Spring Valley Waterworks v. City of San Francisco, 124 Fed. 574 ..... 57, 90, 111-12
St. Joseph Gas Co. v. Barker, 243 Fed. 206 ..... 61, 146
Stafford v. Wallace, 258 U. S. 495 ..... 240, 241
State v. Southwestern Bell Tel. Co., 223 Pac. 771, 15 Kan. 236 94-5
State v. Sugarland Ry. Co., 163 S. W. 1047 217
State Public Utilities Commission v. Chicago & W. T. Ry. Co., 114 N. E. 325 229-30
Sunshine Anthracite Coal Co. v. Adkins, 310 U. S. 381 ..... 235, 241, 242, 247, 248
Re Sweetwater Water Corp., P. U. R. 1922B, 336 142
Texoma Natural Gas Co. v. Railroad Commission, 59 Fed. (2) 750 240
Town of Irvington v. Commonwealth, etc., 10 P. U. R. (N. S.) 329 233
Townsend v. Yeomans, 301 U. S. 441 241
Tyson v. Banton, 273 U. S. 418 ..... 240, 247

Union Falls Power Co. v. City of Oconto Falls, 265 N. W. 422 ..... 66, 245
Re United Fuel Gas Co., Case No. 1516, P. U. R. 1925B, 705 ..... 126, 141
United Fuel Gas Co. v. Public Service Commission, 14 Fed. (2) 209 ..... 59, 124, 127, 141
United Fuel Gas Co. v. Public Service Commission, 278 U. S. 322 ..... 59, 124
United Fuel Gas Co. v. Railroad Commission, 13 Fed. (2) 510 124
United Fuel Gas Co. v. Railroad Commission, 278 U. S. 300 ..... 59, 124, 141
United R. & E. Co. v. West, 280 U. S. 234 ..... 57, 114, 177
U. S. v. Appalachian Electric Power Co., 85 L. Ed. 201 247
U. S. v. Hess, 71 Fed. (2) 78 225
U. S. v. Morgan, 307 U. S. 183 263
U. S. v. Mullendore, 35 Fed. (2) 78 226
U. S. v. New River Collieries Co., 262 U. S. 341 113
U. S. v. N. P. Ry. Co., 288 U. S. 490 164
U. S. v. Ohio Oil Co., 234 U. S. 548 238
U. S. v. Rehwald, 44 Fed. (2) 663 226
U. S. v. Rock Royal Cooperative, Inc., 307 U. S. 533 ..... 237, 242
U. S. v. U. S. Shoe Machinery Co., 264 Fed. 138 226
Vogelstein & Co. v. U. S., 262 U. S. 337 113
West v. Chesapeake, etc., Tel. Co., 295 U. S. 662 ..... 57, 112
Western Paper Makers' Chemical Co. v. U. S., 271 U. S. 268 164
Re West Virginia Central Gas Co., P. U. R. 1918C, 453 182
Wichita Gas Co. v. Public Service Commission, 2 Fed. Supp. 792 180-1
Wichita Gas Co. v. Public Service Commission, 3 Fed. Supp. 722 179

Wichita R. R. & El. Co. v. Public Utilities Commission, 260 U. S. 48 ..... 61, 147, 165
Williams v. Standard Oil Co., 278 U. S. 235 ..... 66, 238-9, 242, 247
Willcox v. Consolidated Gas Co., 212 U. S. 19 .. 63, 121-2, 177
Re Wisconsin Telephone Co., P. U. R. 1925D, 661 140
Wisconsin Telephone Co. v. Public Service Commission, 287 N. W. 122 ..... 65, 220, 230-1
Wolff Packing Co. v. Court of Industrial Relations, 262 U. S. 522 ..... 66, 240, 247, 251, 254
Youngstown Sheet & Tube Co. v. U. S. 295 U. S. 476 .. 164

STATUTES.

7 U. S. C. 207(e) 223
7 U. S. C. 211 222
15 U. S. C. 717 4
15 U. S. C. 717c(d) 231
15 U. S. C. 717c(e) 222, 231, 233
15 U. S. C. 717d 10, 50, 60, 62, 166, 218, 221
15 U. S. C. 717d(a) 148
15 U. S. C. 717f 249
15 U. S. C. 717r(b) 50
15 U. S. C. 717r(c) 261
15 U. S. C. 717t 254
16 U. S. C. 824d(e) 223
16 U. S. C. 824e(a) 222
47 U. S. C. 204 223
47 U. S. C. 205(a) 221-2
49 U. S. C. 15(1) 221
49 U. S. C. 15(6) 224
49 U. S. C. 15(7) 223
49 U. S. C. 316(e) 222
49 U. S. C. 316(g) 223

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BRIEF FOR NATURAL GAS PIPELINE COMPANY OF AMERICA AND TEXOMA NATURAL GAS COMPANY.

INTRODUCTION.

These two cases, argued as one, are before this Court on certiorari on the petition (No. 265) of the Federal Power Commission (hereinafter called "Commission") and Illi-

nois Commerce Commission (hereinafter called "complainant"), and on the cross-petition (No. 268) of Natural Gas Pipeline Company of American and Texoma Natural Gas Company (hereinafter called "cross-petitioners").

Opinions Below.

The opinion of the Commission appears at R. Vol. VIII, pp. 3925-3942.

The opinion of the Circuit Court of Appeals for the Seventh Circuit (R. Vol. VIII, pp. 4026-4041) is reported at 120 Fed. (2d) 625.

Jurisdiction.

The jurisdiction of this Court is invoked under Sec. 19(b) of the Natural Gas Act (15 U. S. C. 717 r(b)) and Sec. 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Statute Involved.

The pertinent provisions of the Natural Gas Act of 1938 (52 Stat. 821; 15 U. S. C. 717) are set forth in Appendix A.

Statement of the Case.

Presented for review is a judgment of the Circuit Court of Appeals (R. Vol. VIII, p. 4041) vacating and setting aside a so-called "Interim" order of the Commission (R. Vol. VIII, pp. 3942-3946). The Commission's order directed cross-petitioners to file and put into effect new schedules of rates and charges for natural gas sold at wholesale which should "reflect" a reduction in the operating revenues of Natural Gas Pipeline Company of America of not less than $3,750,000 per annum (R. Vol. VIII, p. 3946).

Cross-Petitioners' Business.

Both cross-petitioners are Delaware corporations with their principal places of business in Chicago, Illinois (R. Vol. I, p. 1). Operated as a single enterprise (R. Vol. I, p. 11), they are engaged in producing, purchasing, transporting, and selling in interstate commerce at wholesale natural gas (R. Vol. I, pp. 11, 557). Three-fourths of their market requirements are produced from their own reserves in the Panhandle gas field of Texas, and one-fourth thereof is purchased from Colorado-Interstate Gas Company at a point near Gray Junction, Oklahoma (R. Vol. VIII, pp. 3998-3999). Cross-petitioners transport their gas through their own pipeline, which extends from the Panhandle gas field to a point near Joliet, Illinois (R. Vol. I, p. 11). Cross-petitioners have never held, and do not now hold, themselves out to sell natural gas to the general public, but have confined their sales to selected buyers under private contracts negotiated between the seller and the buyer (R. Vol. I, p. 11). They are now selling gas under 47 different contracts (R. Vol. II, p. 685). About 90% of the gas sold by cross-petitioners is purchased by Chicago District Pipeline Company, which in turn sells it to public utilities in the Chicago area (R. Vol. I, p. 3). The remaining 10% is sold to certain public utilities and industrial consumers along the pipeline in the States of Kansas, Nebraska, Iowa, and Illinois (R. Vol. I, p. 3).

The construction of cross-petitioners' pipeline was commenced in 1930 (R. Vol. II, p. 653) and completed near the end of 1931 (R. Vol. I, p. 560). Their operation records were set up as of January 1, 1932, at which time, however, not all of the construction work had been fully completed (R. Vol. I, p. 561). Cross-petitioners' evidence before the Commission was to the effect that, assuming the most favorable conditions in producing and transporting natural gas in the light of the quantity of gas contained

in the reservoir in which cross-petitioners' reserves are located and the prospective withdrawals from such reservoir, the latest date to which the economic life of cross-petitioners' reserves will extend will be at the end of the year 1954. Witnesses for cross-petitioners testified that cross-petitioners' business will not continue to such date, but that it will have to be discontinued for economic reasons at a prior date, probably some time between the end of 1951 and 1954 (R. Vol. II, p. 695). On this evidence the Commission assumed, for the purposes of the interim order, that cross-petitioners' business will continue until December 31, 1954 (R. Vol. VIII, p. 3938).

Proceedings Before the Commission.

The effective date of the Natural Gas Act (15 U. S. C. 717) was June 21, 1938. This action was instituted on September 23, 1938, by a complaint filed with the Commission by complainant (R. Vol. I, p. 1). Subsequently, the Commission initiated a general investigation "concerning all rates, charges, classifications", etc., of cross-petitioners (R. Vol. I, p. 6). The two proceedings were consolidated for purposes of hearing (R. Vol. I, p. 14); and evidence was taken before a trial examiner designated by the Commission (R. Vol. I, p. 14). Cross-petitioners were directed to proceed with their evidence before complainant and the Commission completed their testimony (R. Vol. I, pp. 15, 24).[1] Upon completion of cross-petitioners' direct testimony,[2] counsel for the Commission and complainant filed a motion for an "interim" order reducing cross-petitioners' rates and charges (R. Vol. III, p.

1. Because cross-petitioners were unable to proceed with their evidence on the first day of the hearing, counsel for the Commission and complainant put on two witnesses, but thereafter cross-petitioners proceeded with their direct testimony (R. Vol. I, pp. 34, 187).

2. Of the thirty-seven witnesses called by cross-petitioners, only seven have been cross-examined; and complainant and the Commission have called but six witnesses, four of whom testified on subjects related to rate of return.

3903). Upon this motion, the Commission's order under review, dated July 23, 1940, was entered (R. Vol. VIII, pp. 3942-6). The hearing before the Commission has not been concluded (R. Vol. IV, p. 2100).

The Commission's Order and Opinion.

From the Commission's opinion (R. Vol. VIII, pp. 3925-3942) it appears that it was the Commission's view that cross-petitioners' present annual revenues exceed by $3,750,000 the amount which the Commission found to be a proper annual return, a proper annual allowance for amortization, and a proper annual allowance for operating expenses. In analyzing the order and the memorandum opinion of the Commission, it is highly important to remember that cross-petitioners are not public utilities holding themselves out as offering to sell natural gas to the general public. From the beginning of their operations on January 1, 1932, down to the time when the Natural Gas Act became effective, cross-petitioners were engaged in selling natural gas to selected customers at rates fixed by private contracts negotiated between cross-petitioners and their several customers. *This case, therefore, differs from an ordinary public utility case in that cross-petitioners have never themselves dedicated their properties to a public use.* They were engaged in a strictly private business until Congress, through the enactment of the Natural Gas Act (if that Act be valid), dedicated their property to the use of the public. *Another distinction between cross-petitioners and the ordinary public utility is that cross-petitioners are engaged in an extractive industry, the life of which is definitely limited to the life of the source of their supply of natural gas.* Upon the exhaustion of their gas reserves, cross-petitioners' entire investment will become worthless, except to the amount of the salvage value of the physical properties. The evidence,

which the Commission purported to adopt for the purposes of the interim order, shows that at some time prior to December 31, 1954, cross-petitioners' gas reserves will have been exhausted. If the Natural Gas Act operates to impose regulation upon cross-petitioners and subjects their properties to public use during the remaining period through which they will have natural gas available for their operations, the constitutional administration of that Act requires (1) that cross-petitioners be allowed a reasonable return on the value of the property subjected to public use, and (2) that provision be made to return to cross-petitioners by the end of the period the value of the property subjected to public use plus the cost of additional capital facilities which cross-petitioners will be required to provide in order to continue their business.

We shall state briefly the Commission's holding or finding on the several issues presented by this review.

The rate base. Before the Commission and the court below cross-petitioners contended, and now contend, that the proper rate base is as follows (R. Vol. VIII, p. 3935):

Reproduction cost new of physical properties (exclusive of gas reserves) as of June 1, 1939, $56,302,250 less viewed depreciation, $2,866,758	$53,435,492
Value of Gas Reserves as of June 1, 1939	13,334,775
Capital Additions from June 1, 1939, to December 31, 1954	6,046,286[1]
Going Concern Value	8,500,000
Working Capital	975,000
	$82,291,553

1. This figure differs from the $9,145,083 sought for future capital expenditures in the allowance for amortization. The $6,046,286 is the *average investment* for future capital expenditures from 1939, the date of the investigation, to December 31, 1954.

The rate base adopted by the Commission is as follows (R. Vol. VIII, p. 3937):

Reproduction Cost New of Physical properties (exclusive of gas reserves) as of June 1, 1939	$56,302,250
Value of Gas Reserves as of June 1, 1939	13,334,775
Capital Additions from June 1, 1939, to December 31, 1942	3,808,399
Working Capital	975,000
	$74,420,424

The Commission accepted the figures of cross-petitioners for reproduction cost new but did not deduct from that figure the existing or viewed depreciation. The Commission refused to make the deduction on the theory that it was adopting the entire life of the properties (1932 to 1954, inclusive) as the period of amortization and adopting the sinking-fund method for amortizing the entire investment (R. Vol. VIII, p. 3936).

However, in dealing with the gas reserves as a part of the rate base, the Commission took the value of the depleted reserves as of June, 1939 rather than the value of the gas reserves prior to their depletion. Here again the Commission accepted cross-petitioners' figures (R. Vol. VIII, pp. 3935-3937). The inconsistency of the Commission's method of treating the reserves and other physical properties in arriving at the rate base is apparent, though no explanation is found in the Commission's memorandum opinion or order.

With respect to the cost of additional capital facilities, the Commission refused to allow such costs after December 31, 1942. The $6,046,286 which cross-petitioners contended should be allowed for capital additions represents the *average investment* for future capital additions from 1939 (the date of the investigation) to December 31, 1954, in order to carry on their present business. That figure

through those years represents the average amount which cross-petitioners will have invested in the business by way of additional capital facilities.

The Commission excluded from the rate base any allowance for going-concern value of cross-petitioners' property (R. Vol. VIII, pp. 3936-3937).

Rate of return. Before the Commission and the court below cross-petitioners contended, and now contend, that the fair rate of return should be not less than 8% (R. Vol. VIII, p. 3987). Notwithstanding the Commission quoted with approval figures submitted by its own employee (R. Vol. VIII, p. 3939) showing that it would cost cross-petitioners 6.72% per annum to refinance their capital structure, the Commission made a finding that 6½% was a fair annual return upon the rate base fixed as aforesaid (R. Vol. VIII, p. 3945). In fixing the rate of return, the Commission manifestly gave consideration only to the single element of cost of capital.

Amount to be amortized. Before the Commission and the court below cross-petitioners contended, and now contend, that the amount to be amortized is properly made up as follows (Exhibit 211, R. Vol. VII, p. 3902):

Reproduction cost new, excluding gas reserves	$56,302,250
Viewed depreciation (deduct)	2,866,758
Value of gas reserves	13,334,775
Cost of additional property	9,145,083[1]
Going-concern value	8,500,000
Working capital	975,000
	$85,390,350
Less Salvage	1,049,132
	$84,341,218

1. This figure is the total cost of additional properties. It differs from the $6,046,288 in the rate base because the rate base figure is average investment for future capital additions.

The Commission rejected cross-petitioners' contention that the present value of the properties, including going-concern value, plus the cost of additional capital facilities in the future, should be amortized, and held that only the original cost of the properties utilized in the business, *i. e.*, the total amount invested in the properties throughout the life of the enterprise, less the salvage value thereof, should be amortized. The Commission fixed the amount of such original cost less salvage at $78,284,009 (R. Vol. VIII, p. 3944).

Amortization period. Before the Commission and the court below cross-petitioners contended, and now contend, that cross-petitioners have never themselves voluntarily dedicated their properties to a public use; that prior to the enactment of the Natural Gas Act (effective June 21, 1938) cross-petitioners were a strictly private enterprise; and that the operation of the Natural Gas Act, if valid, was in legal effect to condemn cross-petitioners' property to public use. Cross-petitioners further contended, and now contend, that in fixing the amortization period it is improper to apply against the amount to be amortized a portion of the earnings of cross-petitioners prior to the beginning of regulation under the Natural Gas Act; that the Government must take cross-petitioners as it found them when it in effect condemned their properties; and that the proper period of amortization is from the beginning of regulation, August 1, 1940, to the end of 1954. The Commission rejected these contentions and held that the proper period of amortization is 23 years, from the first of 1932 to the end of 1954 (R. Vol. VIII, p. 3945); and that cross-petitioners must apply against the amount to be amortized a portion of their earnings prior to the condemnation of their properties.

Interest on sinking fund. Before the Commission and the court below cross-petitioners contended, and now contend,

that under the uncontradicted evidence the maximum interest rate to be used in computing the annual sinking fund allowance is 2% per annum compounded semi-annually (R. Vol. VIII, p. 3981). The Commission adopted the sinking-fund formula for amortization, but set the interest rate to be used in making the computation at the arbitrary figure of 6½% per annum, compounded annually, on the ground that such rate was fair because that was the rate of return allowed (R. Vol. VIII, p. 3935). The Commission ignored entirely the uncontradicted evidence (R. Vol. III, p. 1433) that the types of securities in which a sinking fund would be invested would not yield in excess of 2% per annum compounded semi-annually.

Commission's Conclusion. The Commission summarized its conclusions as follows (R. Vol. VI I, p. 3941):

Income available for amortization and return		$9,362,032
Less amortization		1,557,852
Income available for return		$7,804,180
Rate Base	$74,420,424	
Rate of return	6.5%	
	$4,837,328	4,837,328
Available for reduction in net revenues		$2,966,852
Consequent reduction in Federal income taxes		783,909
Total available for rate reduction		$3,750,761

Commission's failure to fix rates. The Commission did not determine just and reasonable rates and fix the same by order as required by Section 5(a) of the Natural Gas Act (15 U. S. C. 717 d). The Commission's order requires that cross-petitioners' "rates and charges • • • shall be reduced to reflect a reduction of not less than $3,750,000 per annum in the operating revenues of Natural Gas Pipe-

line Company of America" (R. Vol. VIII, pp. 3945-3946), effective retroactively as of August 1, 1940 (R. Vol. VIII, p. 3946).

The Judgment and Opinion of the Circuit Court of Appeals.

Upon cross-petitioners' petition for review the court below vacated and set aside the Commission's order and remanded the case to the Commission for further proceedings in conformity with the opinion of the court (R. Vol. VIII, p. 4041-4042).

The court held (R. Vol. VIII, pp. 4037-4041) that the Commission erred

a. in failing to include in the rate base and in the amount to be amortized an allowance as going-concern value of the actual costs incurred in developing the markets;

b. in fixing the period of amortization at twenty-three years, beginning with the commencement of petitioners' operations on January 1, 1932, several years prior to the enactment of the Natural Gas Act, and ending December 31, 1954, adopted by the Commission as the date at which the economic life of cross-petitioners' reserves of natural gas would be exhausted, instead of the period beginning with the time when cross-petitioners were first subjected to regulation by the enactment of the Natural Gas Act and ending December 31, 1954;

c. in failing to use the present fair value, including going-concern value, instead of the original cost of present facilities, in fixing the amount to be amortized.

The Court did not pass upon cross-petitioners' contention that the maximum interest rate to be used in computing the amortization allowance by the sinking-fund formula is 2% per annum, compounded semi-annually. The Court stated the problem with respect to cross-petitioners' contention that the Commission's finding that the present rates

are unreasonable is not supported by substantial evidence (R. Vol. VIII, p. 4033-4034), but the Court did not expressly rule on this question.

The court held that the Commission's failure to fix rates did not invalidate the order because cross-petitioners were not "aggrieved," and there was "no prejudice" to cross-petitioners (R. Vol. VIII, pp. 4031-4032).

The court below held that there is substantial evidence to support the Commission's finding that 6¼% is a fair rate of return (R. Vol. VIII, pp. 4035-4037).

The court further held that the "interim" order entered by the Commission against cross-petitioners is within the power and jurisdiction of the Commission (R. Vol. VIII, pp. 4034-4035).

The court held that the price regulation sought to be imposed upon cross-petitioners is valid under the Fifth Amendment to the United States Constitution and that the regulation imposed by the Natural Gas Act is valid under the Fifth Amendment, despite the fact that such regulation is imposed with no opportunity to cross-petitioners to withdraw except by permission of the Commission (R. Vol. VIII, p. 4030-4031).

The Commission's order was stayed by the court below prior to the date upon which cross-petitioners were required by the order to file new schedules of rates (R. Vol. VIII, pp. 4025-26).

THE EVIDENCE.

Origin of the Enterprise.

In 1926 it was known that the Texas Panhandle oil and gas field in northwestern Texas contained enormous reserves of natural gas (R. Vol. I, p. 493). No prospective markets for this gas were available within the distance ordinarily traversed by natural gas pipelines; but in the Midwest several large centers of population, including the Chicago area, were not served with natural gas (R. Vol. I, pp. 493-4). At that time some of those who afterwards became the owners of cross-petitioners conceived the idea of developing a pipeline system traversing the more than 950 miles separating the gas field from the Chicago area, to the end that adequate reserves of gas be developed in Texas and that gas be transported by pipeline to supply the needs of that great center of population (R. Vol. I, p. 494). To that end they assembled a corps of engineers under the direction of Floyd C. Brown, now Vice President and General Manager of cross-petitioners, with instructions that they conduct a study and make a report on the feasibility of such a project (R. Vol. I, p. 494). After extensive studies these engineers submitted an adverse report (R. Vol. I, p. 499). They pointed out that no pipeline had ever been constructed over such a long distance and that such an undertaking was confronted with uncertainties and with mechanical and economic difficulties which seemed insurmountable under the then existing conditions. There was no history by which to gauge the prospects of such an undertaking. Gas pipelines then in operation, which traversed comparatively short distances (R. Vol. I. p. 494), utilized a thick walled, lap-weld pipe, held together at the joints by couplings (R. Vol. IV, p. 494-5). They trans-

ported gas at pressures ranging from 400 to 500 pounds per square inch (R. Vol. IV, p. 497). The thick walled pipe ran into tonnage so rapidly that a serious problem of investment cost was at once presented in considering a 950 mile line. It was found that thirty-one rivers traversed the territory over which the line would have to be constructed (R. Vol. I, p. 515). These included the great Mississippi and Missouri Rivers and numerous other streams which assumed dangerous characteristics in flood seasons, such as the Canadian River and the Big Blue River in Texas. Toward the eastern end of the line the problem of keeping the pipe anchored in the prevalent treacherous peat beds appeared almost insurmountable. It was known that when transported at high pressures the moisture contained in natural gas solidified into hydrates which literally choked the line and blocked the passage of the gas. These and other serious difficulties and handicaps prompted this corps of engineers to advise against the undertaking (R. Vol. I, p. 499).

But those who had conceived the enterprise refused to take "no" for an answer. They directed these engineers, and others, to enlist the suport of pipe manufacturers and cooperate with them in the development of some type of thin walled pipe which would overcome the excessive weight and the mechanical defects of the old lap-weld pipe and which would permit the transportation of gas at higher pressures (R. Vol. I, p. 499, Vol. II, pp. 650-1). They directed these engineers also to enlist the support of equipment manufacturers to the end that new facilities, such as compressor units, gate valves and river headers suitable for use in connection with the new type of pipe in contemplation, be developed (R. Vol. I, p. 499, Vol. II, p. 656). They directed that researches be pursued to find a practical means of removing the hydrates from natural gas so that gas could be transported at substantially higher pressures (R. Vol. I, p. 507, Vol. II, p. 650). Years of research and

experimentation followed. By the end of 1929 these engineers and those cooperating with them had found the solution. A thin walled seamless pipe and also a thin walled electric welded pipe had been developed, each of which weighed substantially less per lineal unit than the old type of pipe, and each of which could be utilized under operating pressures in excess of 700 pounds to the square inch (R. Vol. I, p. 506). Other facilities necessary to pipeline operations were designed and adapted for use with these new types of pipe. Practical means of removing the moisture from natural gas, and thus preventing the formation of hydrates, had been developed (R. Vol. II, p. 650). Thus the cost of pipe had been substantially reduced and the utilization of the higher pressures permitted the transportation of a substantially larger volume of gas per unit of steel than had been accomplished by successful pipelines then in operation (R. Vol. I, p. 500).

The original entrepreneurs were now ready to translate their vision into reality. But they had decided to spread the risk to include others (R. Vol. I, p. 501). Meantime others had become interested in supplying the Chicago area with natural gas from the same Texas field (R. Vol. I, p. 501). A number of those other interested parties joined with the original enterprisers in the organization of cross-petitioners early in the year 1930 (R. Vol. I, p. 502).

Cross-Petitioner's Properties.

Cross-petitioners acquired large reserves of gas in the Panhandle field. They originally acquired leases on about 316,000 acres (R. Vol. I, p. 619). This included both desirable and undesirable acreage (R. Vol. I, p. 620). Cross-petitioners were forced to buy leases in blocks and to take the bad with the good (R. Vol. I, pp. 620-1). In view of the drilling and delay rental requirements of the gas leases, cross-petitioners have culled their original leases to elimi-

nate the undesirable (R. Vol. I, p. 623). They have acquired some additional leases to round out and consolidate their holdings (R. Vol. I, p. 623). Cross-petitioners' present holdings cover about 150,000 acres (R. Vol. I, p. 623). On this acreage cross-petitioners have drilled or acquired 171 wells (R. Vol. I, p. 623). Cross-petitioners have been forced to abandon eight of these wells because of "salting" (R. Vol. I, pp. 459, 461). Salt in the formation or well sometimes blocks off the gas (R. Vol. I, p. 455). Cross-petitioners have encountered this trouble in a total of 26 wells (R. Vol. I, p. 462). The equipping of the wells includes a casing for the bore, a meter, and a meter house (R. Vol. II, p. 887). The maintenance of the wells involves treating for "salting," blowing water out, etc. (R. Vol. I, pp. 627-8).

Cross-petitioners will, during the remaining life of their gas supply, have to drill and equip about 215 additional wells to meet their present market requirements (R. Vol. II, pp. 864, 882). In spite of cross-petitioners' efforts to protect their gas reserves, only 40% of the gas withdrawn from under cross-petitioners' leases has been produced through cross-petitioners' wells, the other 60% having been lost through drainage to low pressure areas in the field (R. Vol. I, p. 240).

A gathering system, including mains 24" in diameter and smaller lateral lines, was constructed out over the field for the purpose of gathering the gas at the wells and transporting it to a central point near Fritch, Texas (R. Vol. I, p. 531; Vol. II, p. 910). At Fritch cross-petitioners constructed their initial main compressor station (R. Vol. I, p. 533). This compressor station has 15 compressors, each of which is driven by a 1250 h. p. engine (R. Vol. I, p. 533). Each of these compressor units weighs about 400,000 pounds (R. Vol. I, p. 533). An aerial photograph of the Fritch station appears at R. Vol. V, p. 2803. Also located at Fritch is the cross-petitioners' dehydrating plant (R.

Vol. I, pp. 467-8). Operators of gas pipelines have long been troubled with the forming of hydrates in the line which block the gas and cause considerable trouble (R. Vol. I, pp. 466-7). Cross-petitioners have largely eliminated this difficulty through improvements embodied in their dehydrating plant (R. Vol. I, p. 508). Also located at Fritch is cross-petitioners' natural gas extraction plant (R. Vol. II, p. 768). Natural gasoline is extracted from the gas before the gas is forwarded through the pipeline (R. Vol. II, p. 1069). This natural gasoline is sold by cross-petitioners (R. Vol. II, p. 1069).

From Fritch cross-petitioners constructed their main pipeline, 24 inches in diameter, across Oklahoma, Kansas, Nebraska, Iowa, and on to Joliet, Illinois, a distance of more than 900 miles (R. Vol. I, p. 518). A map showing the route appears at R. Vol. V, p. 2687. Cross-petitioners were the first to build and operate a gas pipeline 900 miles long (R. Vol. I, pp. 497-8). The pipeline is buried in the ground to a depth averaging five feet from the top of the pipe (R. Vol. II, p. 1151). The pipe is laid in 40-foot sections which are alternately welded and coupled together, each coupling being provided with a rubber gasket (R. Vol. I, pp. 508, 520). Through work of great intensity with the A. O. Smith Corporation of Milwaukee and the steel companies, cross-petitioners obtained a thin-walled pipe capable of taking the high pressures contemplated (R. Vol. I, p. 500). The pipe was tested for a pressure of 800 pounds per square inch (R. Vol. II, p. 661). The normal operating pressure is over 700 pounds (R. Vol. III, p. 1316).

In laying the pipeline cross-petitioners had to obtain rights of way from 2500 to 3000 landowners (R. Vol. I, p. 516).

The 31 river crossings present a special hazard. There are two types of river crossings: an overhead suspension bridge and a multiple line submerged crossing (R. Vol. I, p. 521). Cross-petitioners have an overhead suspension

bridge over the Big Blue River in Texas (R. Vol. I, pp. 521-2). Because cross-petitioners underestimated the treacherous nature of the bed of this river, the shifting channel, etc., they twice lost the pipe laid in a submerged crossing (R. Vol. I, p. 522). After these two experiences, cross-petitioners resorted to the overhead bridge (R. Vol. I, p. 522). A picture of the bridge appears at R. Vol. V, p. 2783. At the entry to the bridge is a valve manifold header through which the 24-inch pipe is run into two 18-inch lines (R. Vol. I, p. 521). On the other side of the river the two 18-inch lines converge, through the same type of header, into the single 24-inch line (R. Vol. I, pp. 521-2).

The other river crossings along cross-petitioners' pipeline are of the submerged type. A picture of a typical submerged crossing appears at R. Vol. V, p. 2785. The main 24-inch pipe is reduced through a manifold header to six 12-inch lines which are laid in the stream bed (R. Vol. I, p. 522). The smaller lines are used because of the difficulties in handling a 24-inch line in dredging a trench in the bed of a flowing stream and laying the line below the normal stream bed (R. Vol. I, p. 523). Another reason for the multiple line is that it provides an element of safety. If one line fails, the others may hold and enable cross-petitioners to continue service (R. Vol. I, p. 524). There is a great deal of buoyancy in a gas pipeline (R. Vol. I, p. 524). The lines on a stream bed are clamped down and the lines crossing flood valleys and river bottoms are anchored or weighted down (R. Vol. I, p. 524). The multiple line submerged on a stream bed is arched upstream so that the force of the stream will tend to place the pipe and welded joints in compression rather than tension (R. Vol. I, p. 525). If the lines were laid straight across the stream or curved downstream, the pressure of the water against the pipes would through the pipelines into tension and the welded joints would be subjected to an undue strain (R. Vol. I, p. 525).

In cross-petitioners' business continuous service is all important (R. Vol. I, p. 604). Customers, particularly those serving domestic consumers, must be assured that there will be no interruptions in service, or that interruptions will be kept at a minimum. One of the greatest risks confronting cross-petitioners is line failures (R. Vol. I, p. 604). In February, 1938, cross-petitioners suffered a line failure which resulted in a total loss of about $250,000 (R. Vol. I, p. 604). Any break in the line involves the tremendous hazard of explosion and fire (R. Vol. I, p. 605). Cross-petitioners are handling a highly explosive material under terrific pressures. They must constantly guard against damage to life and property. A break in the line will result in loss of revenue from reduced sales of gas in addition to the expense of repairs (R. Vol. I, p. 604).

The weight of the gas adds to the mechanical problems in the construction and operation of the pipeline (R. Vol. II, p. 932). The gas makes two 90-degree turns in passing through a header (R. Vol. II, p. 932). The weight of the gas passing a header every 24 hours is about 5,250 tons (R. Vol. II, p. 932). This weight is equivalent to the weight of 3,500 automobiles passing over the header each 24 hours at the rate of 14 miles per hour (R. Vol. II, p. 932). The maintenance of the pipeline involves such jobs as welding a sleeve (a heavy plate of steel) to the pipeline while the line is in operation (R. Vol. III, p. 1316). The pipeline, carrying pressures of over 700 pounds per square inch and having a daily flowing capacity of 210,000,000 cubic feet, is continued in operation while the welder raises the wall of the pipe to a fusing heat to weld the sleeve to the pipe (R. Vol. III, p. 1316).

On an average of about every 90 miles along the pipeline is a compressor station (R. Vol. I, p. 533). There are ten such stations including the one at Fritch. Some of the stations along the line have 6 compressor units, each hav-

ing a 1250 h.p. engine; others have 5 such units (R. Vol. I, p. 533).

Cross-Petitioners' Marketing Contracts.

Cross-petitioners sell their gas in and around the Chicago area and to purchasers along their pipeline (R. Vol. I, p. 3). A total of 161 contracts have been made—all by private negotiation (R. Vol. II, p. 685). Of these contracts, 47 were still in effect when the record was made (R. Vol. II, p. 685). Of these 47 contracts, 20 cover a supply of natural gas to be resold for domestic consumption (R. Vol. II, p. 685). These 20 contracts are referred to as "firm" contracts (R. Vol. II, p. 685). Under them cross-petitioners are obligated to deliver gas to the capacity of their pipeline (R. Vol. II, p. 685). Of these 20 contracts, one expired in 1939, 8 will expire in 1941, and 11 in 1946 (R. Vol. II, p. 685). Included among the 11 is the contract with the Chicago District Pipeline Company, which may be extended for 5 years beyond 1946 at cross-petitioners' option (R. Vol. II, p. 685). Of the remaining 27 contracts, 2 cover the sale of gas at the wells (R. Vol. II, p. 685) and 25 are for the sale of gas for industrial use (R. Vol. II, pp. 685-6). The industrial contracts are "interruptible" (R. Vol. II, p. 686). They provide for interruption of service in the event that the cross-petitioners are unable to supply gas after the obligations of the firm contracts are met (R. Vol. II, p. 687). The interruptible contracts are divided into classes, each class taking precedence over the lower classes in the event that the cross-petitioners are unable to serve all (R. Vol. II, p. 687). The higher classes pay a higher rate (R. Vol. II, p. 687).

The interruptible industrial contracts are mostly for short periods of time and do not obligate the purchasers to take a minimum amount of gas (R. Vol. II, p. 687). These contracts are in fact only an option to the pur-

chasers to take gas from cross-petitioners' pipeline (R. Vol. II, p. 689). The purchasers pay only for what they take (R. Vol. II, p. 689). During the year 1937, when cross-petitioners had brought their pipeline load up to capacity, cross-petitioners' industrial sales were $3,775,-215.64 out of a total gross of about $15,000,000 (R. Vol. II, p. 690). The industrial consumption in that year was 29,118,904,000 cubic feet. The next year, 1938, the industrial consumption declined to 24,304,875,000 cubic feet (R. Vol. II, p. 690), and the revenues declined to $3,069,485.53 (R. Vol. II, p. 690). The decrease in revenue from this service amounted to approximately $706,000. The total revenues of cross-petitioners declined approximately $1,-300,000 in 1938 as compared with 1937 (R. Vol. I, p. 584). The industrial consumption is subject to fluctuations in business conditions in general and in the particular industries served (R. Vol. I, p. 582). It is also subject to the physical hazards connected with pipeline operation, competition with other fuels, etc. (R. Vol. I, pp. 571-2). The total income under cross-petitioners' firm contracts will not support cross-petitioners' pipeline operations (R. Vol. I, p. 581).

The Load Building Period.

The actual construction of the pipeline and facilities was commenced during the summer of 1930 (R. Vol. II, p. 653). By the 15th of October, 1931, the construction had proceeded to the point that cross-petitioners were able to transport some gas through the line to its northern terminus at Joliet, Illinois, and from that date cross-petitioners delivered and sold some gas (R. Vol. II, pp. 662-3). By the end of 1931 the construction of the system was so near completion that cross-petitioners' books and records were later set up on an operating basis as of January 1, 1932 (R. Vol. II, p. 664).

In the beginning cross-petitioners were equipped to transport 175,000,000 cubic feet daily; but their market outlet at that time was only 60,000,000 cubic feet daily (R. Vol. II, p. 675). The development of markets up to the total capacity was a tedious, long and expensive process. Prospective purchasers were using other fuels. For cooking they were using artificial gas. For water heating and house heating they were using coal or oil. For space heating and for the firing of industrial boilers they were using coal, oil, kerosene or distillate. The change-over from any of these fuels to the use of natural gas involved expense and inconvenience, and efforts to introduce natural gas met with stubborn sales resistance (R. Vol. II, p. 1277), to overcome which required great expenditure of time, effort and money (R. Vol. II, p. 677). Four years passed before the demand equaled the original rated capacity of the line (R. Vol. II, p. 676; Vol. III, p. 1329). During this period large sums of money, aggregating $1,567,791, were expended in contributing to retail sales campaigns by the utilities purchasing gas from cross-petitioners, in advertising, in personal solicitation, and in other promotional activities (Exhibit 180, R. Vol. V, p. 2943; Vol. III, p. 1340).

But this was not all the cost incurred. In the pipeline industry it is impractical in the beginning to install pipelines and facilities barely adequate to supply the market outlets then developed and subsequently add to the facilities as the load develops (R. Vol. II, p. 1279; Vol III, p. 1328). It requires two 18-inch pipelines or six 12-inch pipelines to transmit the same quantity of gas which may be transported at the same pressure through a 24-inch line (R. Vol. I, p. 531). The reserves must be located with reference to the gathering system to prevent unnecessary investments in field gathering lines (R. Vol. I, p. 623). Prudent management requires that in projecting a pipeline system adequate reserves and facilities be provided in the

beginning to produce and handle the ultimate volumes of gas for which markets can be developed over a reasonable period of years (R. Vol. II, p. 1279). A part of the reserves and facilities necessarily will stand by during the load building period—to a diminishing degree as the load is built up. Such reserves and facilities cannot be provided in advance of the load except at substantial carrying costs to the investor. Cross-petitioners' original investment was raised by the issuance of interest bearing bonds and the assuming of some interest bearing notes (R. Vol. II, p. 1279). The interest on these bonds and notes and the *ad valorem* taxes on the original reserves and facilities to the extent that the payments were made on capital tied up in these standby reserves and facilities represented out-of-pocket costs. Meantime the depreciable facilities were sustaining depreciation through deterioration, and, to the extent that the depreciable facilities were standing by awaiting the loading of the line, this depreciation represented out-of-pocket costs during the load building period. The non-varying operating expenses, that is, those operating expenses which did not vary with the volume of gas handled during the load building period, were fixed by the requirements of a plant equipped to handle a full load. In other words, these expenses were just as great during the period of load building as they would have been had the line been loaded. To the extent that the facilities were standing by awaiting the loading of the line, these operating expenses represented out-of-pocket costs during the period of attaching business (R. Vol. II, p. 1281).

Other substantial costs in the same connection, not stated in terms of dollars, included that of assembling and training the organization and acquainting the personnel with their respective duties throughout the widespread system, that of assembling and developing records, reports and systems of accounting, and that of seasoning the various

units of plant equipment throughout the system (R. Vol. II, p. 1282).

The witness Emery summed up these elements of cost, not including the three last mentioned, at $8,568,093. Using these cost figures as the basis of his testimony, he testified that cross-petitioners' properties possess a going concern value in addition to the value of the "bare bones" or inert physical properties of at least the amount stated (R. Vol. III, p. 1337). He testified also that it would require an expenditure of at least that amount to reproduce this going-concern value, if cross-petitioners were now at the beginning of their operations (Exhibit 130, R. Vol. V, p. 2943; Vol. III, p. 1340). Another witness, Hamilton, arrived at total cost figures during the load building period of $8,500,000 (R. Vol. II, p. 1282), and upon the basis of those figures testified that cross-petitioners' properties having a going concern value in excess of the value of the inert physical properties of at least the amount last stated (R. Vol. II, p. 1282).

As the operations continued through the load building period, the management and engineering staff, by careful observation, experimentation and research and through the adding of certain capital facilities, by the end of the year 1935 built up the operating discharge pressure to 710 pounds and the operating fiber stress to approximately 25,130 pounds per square inch on the electric welded pipe and 27,650 pounds on the seamless pipe, an achievement never attained by successful pipeline operators with the types of pipe and facilities in use prior to the construction of cross-petitioners' line (R. Vol. IV, pp. 2597-8). Through this initiative and engineering skill, cross-petitioners built up the rated daily capacity of the system from the original 175,000,000 cubic feet to 210,000,000 cubic feet (R. Vol. II, p. 677; Vol. III, pp. 1330, 1467).

Cross-petitioners, by the exercise of creative skill in the

design and construction of their facilities, and of careful and sustained diligence have developed a capacity per pound of steel far above anything that had been developed or even conceived (R. Vol. II, pp. 1046-7), and have built up a capacity factor far above that of any other large system (R. Vol. III, p. 1467). By negotiation they have succeeded in obtaining interruptible industrial outlets for the excess volume of gas, which can be handled economically through their facilities, above the demand under their firm contracts for gas to be used ultimately for domestic and commercial purposes (R. Vol. II, pp. 683-4). By this means they have built up their annual load factor to more than 92% of the total rated capacity of their facilities (R. Vol. III, p. 1330).

A very substantial portion of the revenues of cross-petitioners ($1,207,067 of a total of $14,853,600) is realized from the sale of additional volumes of gas which cross-petitioners have produced, transported and sold through the increase in the daily capacity of their facilities from the original 175,000,000 to 210,000,000 cubic feet and through the building up of their annual load factor to more than 92% of the total rated capacity (R. Vol. III, p. 1468).

Cross-Petitioners' Gas Reserves.

The Panhandle gas field embraces approximately 1,400,000 acres spread over an area 125 miles long by an average of about 15 miles wide (R. Vol. I, p. 199). Along the northeast flank of the field at irregular intervals large deposits of oil have been encountered in the same formations which produce free gas at higher structural levels (R. Vol. I, p. 202). The production of oil from these areas has been attended with enormous production of natural gas (R. Vol. I, pp. 202-3). Those engaged in other activities in the vicinity of the oil fields, particularly the natural gasoline and carbon black industries, have produced tremendous quantities of natural gas (R. Vol. I, pp. 202-3). As a

result of these heavy withdrawals, low pressure areas were soon formed along the northeast side of the field (R. Vol. I, pp. 211-220). Continued heavy production has resulted in the spreading of these low pressure areas out over the field, until there is now scarcely any portion of the field where the original pressure of about 430 pounds per square inch at the wellhead prevails (R. Vol. I, pp. 211-220).

Cross-petitioners' reserves are located along the central portion of the field in areas of relatively high pressures (R. Vol. I, p. 623); but the regional drainage toward the low pressure areas to the northeast has resulted, and is resulting, in the depletion of the gas from cross-petitioners' reserves at a much more rapid rate than would result from cross-petitioners' production alone (R. Vol. I, pp. 240, 354). Tremendous quantities of gas have been produced from the field from the year 1926 down to the present time (R. Vol. I, pp. 238-9). The production at present goes to pipelines, natural gasoline extraction plants, carbon black plants, or is utilized in the production and refining of oil and in other oil field industrial operations (R. Vol. I, pp. 629-646). Large quantities are wasted directly to the air in connection with the production of oil (R. Vol. I, p. 644). In 1939 the annual production was about 586,677,575,000 cubic feet and was increasing from year to year (R. Vol. I, pp. 629-646).

Qualified geologists conducted extensive studies and testified concerning the quantity of recoverable gas originally in the field and now remaining in the field (R. Vol. I, pp. 306-7; Vol I, pp. 245, 352, and Vol. I, pp. 237, 238). Exhaustive studies indicate that, at the rate of the probable withdrawal, the maximum life of this field will not extend beyond the end of the year 1954 (R. Vol. II, p. 695). The uncontradicted evidence is to the effect that cross-petitioners' operations will prove uneconomic, and for that reason will terminate, sometime prior to the end of

1954 (R. Vol. II, p. 695). For the purposes of the interim order, the Commission accepted cross-petitioners' evidence as to the probable life of the field, except that it assumed production of the requirements of the line to full capacity to the end of 1954, ignoring the evidence that cross-petitioners' operations will cease some time prior to the end of 1954, and fixed the date last named as the end of the period of amortization (R. Vol. VIII, p. 3938).

Capital Additions to Cross-Petitioners' Properties, and Replacement, Maintenance and Operating Expenses.

Down to the present time most of the wells connected to cross-petitioners' gathering lines have produced at pressures sufficient to force the gas through the gathering system to the initial compressor station near Fritch, Texas (R. Vol. I, p. 532; Vol. II, pp. 867-870). These pressures are declining, however; and already it has been necessary to install one field compressor station for the purpose of boosting the gas from wells in the vicinity into the gathering system (R. Vol. I, p. 633). As the pressures continue to decline it is inevitable that additional compressor units will have to be installed throughout the area on which cross-petitioners' wells are located in order to transport the gas from the wellhead to the initial compressor station in such quantities as to supply the demands upon the pipeline (R. Vol. I, p. 633).

Cross-petitioners have drilled or acquired about 171 wells during the years 1932 to 1938, inclusive (R. Vol. I, p. 623). In the past many of the wells have been drilled to satisfy drilling obligations and to protect cross-petitioners' reserves against drainage to the wells of others (R. Vol. I, p. 562). The decline in pressures is accompanied by a more rapid decline in the productive capacity of the gas wells (R. Vol. II, pp. 699, 875). Consequently, cross-petitioners will be required to drill a large number of additional wells

in order to keep the productive capacity at such levels as that the wells can be produced prudently at the rate necessary to supply cross-petitioners' markets (R. Vol. II, p. 875). Careful studies reveal that a minimum of 215 additional wells must be drilled during the period beginning with 1939 and ending with 1952 (R. Vol. II, p. 864). Each of these wells must be equipped with a meter and regulator and other capital facilities. To each of these wells a pipeline must be laid in order to transport the gas into the gathering system. The increasing number of wells and units of well equipment, the laying and maintaining of additional gathering lines, and the field compressor stations will require additional personnel, additional housing and transportation facilities, and additional capital maintenance facilities (R. Vol. II, pp. 891, 893, 928).

The experience of the past years has disclosed that additional capital facilities must be provided in order to insure continuous service through the pipeline system. Several river crossings have already been replaced and others must be replaced (R. Vol. II, pp. 912-918). Added facilities must be provided for the gasoline plant, the dehydrating plant, and each of the ten compressor stations (R. Vol. II, pp. 771, 819-837). Electrolysis has developed in the soil at several places traversed by the pipeline, resulting in serious deterioration in the pipeline and connections (R. Vol. II, p. 926). Capital outlays will be required to anticipate and prevent damage of this character. It is now clearly foreseen that still other additional capital facilities will have to be provided in order to insure the continued operation of cross-petitioners' facilities (R. Vol. II, pp. 1056-8).

An exhaustive study of the future capital requirements of cross-petitioners to cover the cost of drilling and equipping wells, building additional gathering lines, field compressor stations, maintenance equipment, housing facilities, river crossings, and other capital requirements was con-

ducted at the direction of cross-petitioners' general superintendent, Kesinger (R. Vol. II, pp. 704-5), under the supervision of a specially qualified engineer, Bussard (R. Vol. II, p. 704), with whom all the department heads and other employees of cross-petitioners and two experienced outside engineers of wide reputation, Biddison and Gill, collaborated (R. Vol. II, p. 705). The same study developed the cost of replacements and maintenance of the facilities and the cost of operations, taxes, and other necessary expenditures over the future life of the field. Future capital equipment, replacements, maintenance and operating costs were computed in these studies at costs of labor and material prevailing on the first of June, 1939, a date shortly prior to the offering of the testimony. Taxes were computed on the basis of the then levies, notwithstanding cross-petitioners' witnesses then predicted that taxes will increase (R. Vol. II, pp. 1058-9), a prediction which has already been vindicated (R. Vol. VIII, p. 3945).

The evidence dealing with future capital maintenance and operating costs is unequivocally to the effect that only those charges have been included which definitely can be foreseen now as inevitable (R. Vol. II, p. 706), though the witnesses knew that there were other expenditures in all these classifications which would certainly be required but which cannot be definitely foreseen at this time (R. Vol. II, p. 706).

Future Revenues of Petitioners.

During cross-petitioners' entire operations their general superintendent, Kesinger, has been responsible for their marketing activities, except as to natural gasoline, for the marketing of which the superintendent of operations, G. M. Davidson, has been responsible (R. Vol. II, p. 1069). These executives made careful analyses of the probable future revenues from the sale of gas (R. Vol. II, p. 696) and natural gasoline (R. Vol. II, p. 1080). In

estimating the future revenues from the sale of gas the witness Kesinger assumed that the average revenues for the years 1936, 1937 and 1938, the three full years during which cross-petitioners had operated after developing a full load, would continue through 1951 (R. Vol. II, p. 695). No effort was made to predict the probable revenues by years for the reason that the consumption of natural gas is very sensitive to changes in weather conditions and to business fluctuations (R. Vol. II, pp. 696-7). The testimony shows that cross-petitioners' gross revenues in 1938 were more than one million dollars less than in the previous year (Exhibit 136, R. Vol. V, p. 2959). In selecting the average revenues from the sale of gas for the years 1936, 1937 and 1938 as the basis of computing future revenues from that source, the witness observed that there doubtless would be years like 1937 when the revenues would exceed this average, but that there would likewise be years like 1938 when the revenues would be less than the average (R. Vol. II, p. 697).

Cross-petitioners urged that in view of the fact that theirs is an extractive industry and that the life of their entire investment depends upon the limited life of their reserves, the Commission should look forward over the remaining prospective life, in the light of the uncontradicted testimony, and allow, in fixing the amount to be amortized, the entire cost of additional capital facilities, and that it provide in the allowance for expenses each year the average annual cost of capital replacements and the estimated costs for maintenance and operations (Exhibit 141, R. Vol. V, p. 3025, Vol. III, p. 1411; Exhibit 210, R. Vol. VII, p. 3901, Vol. IV, p. 2637; Exhibit 142, R. Vol. V, p. 3029, Vol. III, p. 1414; Exhibit 211, Vol. VII, p. 3902, Vol. IV, p. 2638, all of which costs are summarized in Exhibit 117, R. Vol. V, p. 2819, Vol. II, p. 1068). Cross-petitioners urged also that in view of the limited life of their business and the expense and delay incident to repeated rate proceedings,

the Commission should take into account the cost of additional capital facilities now definitely foreseen and make an additional allowance in the rate base, under the principle of average investment, over the future life of the project (Exhibit 141, R. Vol. V, p. 3025, Vol. III, p. 1411; Exhibit 210, R. Vol. VII, p. 3901, Vol. IV, p. 2637; Exhibit 142, R. Vol. V, p. 3029, Vol. III, p. 1414; Exhibit 211, R. Vol. VII, p. 3902, Vol. IV, p. 2638).

For the purposes of the interim order, the Commission accepted cross-petitioners' estimates of the cost of additional capital facilities, capital replacements, maintenance and operation through the year 1954, and allowed the cost of additional capital facilities and capital replacements in fixing the amount to be amortized (R. Vol. VIII, p. 3944). For the purposes of the order, the Commission also accepted cross-petitioners' estimates of future revenues (R. Vol. VIII, p. 3945). However, the Commission in fixing the rate base allowed capital additions only through December 31, 1942 (R. Vol. VIII, p. 3936).

Reproduction Cost New of Cross-Petitioners' Property.

After exhaustive studies, a group of qualified and experienced experts, Hamilton, Eastman, Willard, and Stoddart, developed the figures showing the reproduction cost new of cross-petitioners' present facilities other than gas reserves (R. Vol. II, pp. 1191-1276). Another witness, Biddison, well qualified for the assignment, carefully went over the depreciable properties and testified as to the existing depreciation thereon (R. Vol. II, pp. 1284-1310). The two sets of figures were put together, and the figures showing the reproduction cost new less observed depreciation of the depreciable properties were compiled (Exhibit 125, R. Vol. V, pp. 2922-5; Vol. II, p. 1310). Another expert, Wallace, after careful analysis, testified to the present fair value of the gas reserves (R. Vol. III, pp. 1341-

66). An expert, Eastman, testified as to the required working capital (R. Vol. II, pp. 1231-3). Three business men of long years' experience, Smith, Taubman, and Solow, testified to the probable salvage value of cross-petitioners' facilities (R. Vol. II, pp. 1119-90, Exhibit 122, R. Vol. V, p. 2841, Vol. II, p. 1190). The figures showing the original cost of the capital facilities in use as of January 1, 1939 (Exhibit 141, R. Vol. V, p. 3025; Vol. III, p. 1411), and as of June 1, 1939 (Exhibit 142, R. Vol. V, p. 3029; Vol. III, p. 1414), were offered in evidence.

The Commission, for the purposes of this order, accepted cross-petitioners' figures covering reproduction cost new of the depreciable properties other than leaseholds, the value of the leaseholds, the required working capital, the ultimate salvage value of the properties, and the original cost of the physical facilities.

Interest on Sinking Fund for Amortization.

Bearing on the proper allowance for amortization, cross-petitioners called a banker, Zweiner, Assistant Cashier of the Harris Trust & Savings Bank, Chicago, to testify as to the character of securities which an investment trustee would consider available in handling a trust fund of the size of the annual allowance for amortization (R. Vol. III, pp. 1367-79). The witness testified that, under the existing conditions, the nearest to risk free securities available would be government bonds and high class municipal bonds, and that of these securities only government bonds were available at all times (R. Vol. III, p. 1369). He listed all the government bonds outstanding at the time he testified on September 7, 1939 (Exhibit 132, R. Vol. V, p. 2951; Vol. III, p. 1377), and from this list selected those he considered available (Exhibit 133, R. Vol. V, p. 2953; Vol. III, p. 1377). He then calculated the yield on the bonds available at the prices as of August 15, 1939, the date on

which he started his studies, and determined that the net yield to the investor on such investments would be 1.35% per annum over the period ending with the year 1954 (R. Vol. III, p. 1374). As a result of the outbreak of war shortly after this witness' figures were prepared, the yields on government bonds advanced (R. Vol. IV, p. 2130). Another witness, Delafield, who has had wide experience as a banker and later as a financial executive in a company owning extensive natural gas pipeline and public utility properties, testified that in his opinion about 2%, compounded semi-annually, would be the proper rate to use in computing an amortization allowance by the sinking fund formula (R. Vol. III, pp. 1433, 1435).

Return on Investment Over Entire Life of Properties.

Bearing on cross-petitioners' contention that in testing their prices and charges, to determine whether or not they are unreasonable and unjust, *their investments and earnings throughout the whole period from the beginning of their operations on January 1, 1932, to the time when their reserves will be exhausted should be considered, cross-petitioners prepared and offered the figures showing past and future capital investments, including replacements, past and future operating expenses, and past and future revenues, from which it appeared that, after returning the capital investment and paying the expenses of operation, the revenues over the whole period would yield to cross-petitioners a return of only 6.39% on the average annual investment* (Exhibit 140, R. Vol. V, p. 3021; Vol. III, p. 1407). The summary sheet of Exhibit 140 is reproduced in Appendix B hereto, p. 274, *infra*.

Exhibits Summarizing Revenues, Costs, Etc., of Cross-Petitioners.

Going to the issues involved in fixing probable charges, should the Commission find it proper to fix reduced charges, cross-petitioners caused to be prepared, and offered in evidence, two exhibits, Nos. 141 and 142 (R. Vol. V, pp. 3025, 3029; Vol. III, pp. 1411, 1414). In Exhibit 141 the estimated revenues set out in the testimony to which we have already referred were used, as were also the figures covering the costs of operation and maintenance and the cost of replacements. In arriving at the assumed present fair value in this exhibit, the original cost of the capital assets other than gas reserves, less viewed depreciation of the depreciable assets, and the original cost of the gas reserves less depletion were used. To this assumed present fair value was added $8,500,000 as going concern value and $975,000 as working capital, with an additional allowance, under the principle of average investment, during the future years to cover the cost of additional capital facilities, bringing the total rate base up to $75,305,459. Also the figures of the experts who testified on that subject as to the liquidating salvage value of the properties were used in this exhibit. The total amount to be amortized assumed in this exhibit was $77,513,135, representing the present fair value of the properties, including going concern value and working capital, plus $9,338,983 to cover cost of additional capital facilities in the future, less the liquidating salvage value in the amount of $1,049,132. The allowance for amortization assumed was computed by determining what amount, set aside annually, with interest at 1.35% compounded annually, would, during the period beginning January 1, 1939, and ending December 31, 1954, return to cross-petitioners the full amount to be amortized. From all these figures it was determined that, if the present fair value of the property

be assumed at original cost less existing depreciation and depletion, cross-petitioners would receive a return on the rate base assumed as aforesaid of only 4.79% per annum during the remaining life of their project (Exhibit 141, R. Vol. V, p. 3025; Vol. III, p. 1411). Later this exhibit was revised by Exhibit 210, which differs from Exhibit 141 only in that in computing the allowance for amortization an interest rate of 2% compounded semi-annually was used in order to conform the figures to the testimony offered by cross-petitioners at a date subsequent to the offering of Exhibit 141. Exhibit 210 shows that, on the rate base assumed in Exhibit 141, cross-petitioners' present revenues, after proper allowance for amortization, would return over the remaining life of the field an average of 5.1% per annum (R. Vol. VII, p. 3901). Exhibit 210 is reproduced herein in Appendix C, p. 275, *infra*.

Exhibit 142 was substantially similar to Exhibit 141, except that there cross-petitioners assumed as the present fair value of the property the reproduction cost new of the present facilities other than leaseholds, less viewed depreciation, and as the present fair value of the reserves the figures of the expert on that subject. On such basis it developed that, after paying the operating expenses and costs of replacement and setting aside an amount each year sufficient to return the present fair value of the properties, including going concern value, working capital, and the proper allowance for additional capital facilities, computed on the basis of an interest rate of 1.35% compounded annually, the return to cross-petitioners on the proper rate base during the future life of the field would be an average of 3.69% (Exhibit 141, R. Vol. V, p. 3025; Vol. III, p. 1411). This exhibit was also revised (Exhibit 211) to conform the allowance for amortization to the revision in the interest rate used from 1.35% to 2%. On that basis it developed that, after setting aside an amount

each year sufficient to provide for amortization and after paying the expenses of maintenance and operation, cross-petitioners will receive an annual return on the proper rate base of 4% per annum (R. Vol. VII, p. 3902). Exhibit 211 is reproduced herein in Appendix D, p. 276, *infra*.

Evidence Relating to Rate of Return.

The only controverted issue of fact presented by the opinion and order is the fair and reasonable rate of return to which cross-petitioners are entitled. The facts relating to the subject of going concern value and the holdings of the Commission and the Court below thereon present questions of law as to the legal effect of the testimony. On other issues, including the rate base, the amount to be amortized, the working capital and ultimate salvage value, the Commission, for the purposes of this order, accepted the testimony offered by cross-petitioners. Other issues involved present pure questions of law.

Cross-petitioners urge that in finding that 6½% per annum is a fair and reasonable return the Commission erred as a matter of law in that there is no substantial evidence to support such finding (R. Vol. VIII, p. 3987). In order to present this point clearly it will be necessary to state in some detail the facts going to the subject of rate of return.

Cross-petitioners contend that of all the regulated enterprises the natural gas pipeline industry, engaged only in the production, transportation and sale at wholesale of natural gas, is the most beset with risks and hazards. They contend also that, by reason of the geological and production problems and the competition among the thousands of producers in their single source of supply, the mechanical problems presented by the numerous rivers traversed by their pipelines and other topographical conditions, and the long distance separating their source of

supply from their markets, cross-petitioners are confronted with special hazards not common to all those engaged in the same business.

It is impracticable to point out here all the evidence dealing with the numerous risks with which cross-petitioners are confronted; but we will undertake to mention some of these major dangers and risks pointed out by witnesses for cross-petitioners.

1. *The Danger of Failure in the Supply of Gas.* For the purposes of this case the Commission accepted the estimate of cross-petitioners' witnesses that the maximum life of cross-petitioners' source of supply will not extend beyond the end of 1954 (R. Vol. VIII, p. 3938). In the evidence it was pointed out that the field might not last that long, or that economic conditions in cross-petitioners' business might result in an earlier termination of cross-petitioners' business (R. Vol. II, p. 695). As a consequence of the operation of any or all of a number of factors, such as increased withdrawals, physical complications and economic developments, cross-petitioners' business may terminate prior to the end of the maximum life assumed (R. Vol. II, p. 695). Investors buying bonds of natural gas companies protect themselves against these contingencies by requiring that the bonds mature at a date materially in advance of the indicated exhaustion of the reserves (R. Vol. III, pp. 1430, 1501, Vol. IV, pp. 2607-8). The Commission, in fixing the rate of return, failed to give effect to inherent risks respecting the gas supply, made no provision in the allowance for amortization for these manifest contingencies. Cross-petitioners, therefore, are faced, and will continue to be faced, with the very serious risk that they will lose that part of their capital which the Commission has assumed they will recover during the latter part of the project's life.

2. *The Danger of Increased Costs.* In cross-petitioners'

estimates of costs in the future of additional capital facilities, replacements of existing facilities, maintenance, and operating expenses, the costs of materials and labor were computed on prices as of June 1, 1939 (R. Vol. II, p. 837). The estimates of taxes were based on levies in effect on the date last mentioned (R. Vol. II, p. 1058). Conditions point to an increase in costs of materials and labor (R. Vol. I, pp. 450-1) and to increased taxes (R. Vol. I, p. 600, Vol. III, p. 1579). This Court will take judicial notice of the fact that the predictions of this record in these respects have been borne out. The Commission in its order made allowance for one substantial tax increase occurring during the interval between the offering of the testimony and the entering of the order (R. Vol. VIII, p. 3945). Cross-petitioners are faced with substantial risks that all these costs may materially increase during the period covered by a rate order entered at this time (R. Vol. III, pp. 1582-3).

3. *Dangers Incident to Employment of High Pressures and High Stresses.* The fact that cross-petitioners' facilities are operated at substantially higher pressures and stresses than have heretofore been employed by the pipeline industry presents a serious element of uncertainty (R. Vol. III, p. 1568). As pointed out by a witness, it is a matter of common knowledge that as equipment is worked or stressed toward ultimate capacity and is continuously employed at a very high percentage of total capacity, there is a tendency to fatigue, and in the absence of experience as a guide there is always a serious question as to how long the facilities will hold up under the excessive strain, regardless of how well they are maintained or how well they have held up down to the present time (R. Vol. III, p. 1456). The same witness pointed out that it is entirely possible that cross-petitioners may find it necessary to reduce the stresses in the interest of safety to life and property. A relief of the stresses must be accomplished

by a reduction in operating pressures, with a consequent reduction in the volume of gas transported. Another alternative might be to increase the cost of replacements and maintenance incident to the failure of the facilities operated at their present high stresses (R. Vol. III, p. 1456). Cross-petitioners are, and will continue to be, confronted by a serious risk that their revenues may be reduced by the necessity to reduce stresses, or that their costs of operation will be increased to offset the effect of employing the high stresses to which their facilities are now subject (R. Vol. III, p. 1456).

4. *Danger of Pipeline Failure.* Notwithstanding the fact that cross-petitioners' pipeline system has been in operation only eight years, several line failures have already occurred, one of which proved to be rather serious, resulting in interruption of service and in costs, including loss of revenues, of nearly $250,000 (R. Vol. I, p. 604). Already one river crossing has failed and others have been seriously damaged (R. Vol. I, p. 522). In estimating their revenues in the future, cross-petitioners assumed continuous service and only the replacement and maintenance of capital assets which now definitely can be foreseen. Cross-petitioners are confronted with the risk that serious losses of revenue or substantially increased costs, and possibly both, may result from failures of the pipeline in the future.

5. *Danger That Another Source of Supply Nearer to Cross-Petitioners' Market May Be Discovered.* If a circle be drawn about the City of Chicago with a radius of 950 miles, the distance traversed by cross-petitioners' lines, it would embrace an enormous territory. The discovery of gas in sufficient quantities anywhere within that territory would place cross-petitioners in competition with others who manifestly would be able to produce and transport gas to cross-petitioners' markets at lower cost than can cross-petitioners. It is a matter of common knowledge that the fascinations of the oil business have for years

resulted in exploration activities throughout the United States, and no one can tell when a tremendous reserve of natural gas within three or four hundred miles, or even at a shorter distance from Chicago, may be discovered. Already free gas has been discovered in substantial quantities in southern Illinois, not more than one-third as far away from Chicago as the Texas Panhandle (R. Vol. I, pp. 591-2). Other important discoveries of natural gas have occurred in Michigan, less than half the distance from Chicago of cross-petitioners' reserves (R. Vol. I, pp. 591-2). Recently an extensive lease play has taken place in the Forest City basin in southeastern Nebraska, not more than one-third the distance down cross-petitioners' line from Chicago (R. Vol. I, p. 592). Large reserves of gas across the Ohio River in Kentucky, only about half the distance from Chicago as cross-petitioners' reserves, are already known to exist (R. Vol. III, p. 1764). Cross-petitioners' industrial contracts do not require minimum purchases. The firm contracts will not support cross-petitioners' operations (R. Vol. I, p. 581).

6. *Danger of Competition With Other Fuels.* Cross-petitioners must meet serious competition with other fuels and electricity in every use to which consumers apply natural gas. In the kitchens, where the gas consumed commands the highest price of any gas, the gas range or cook stove is in keen competition with the electric range, electric roaster and the electric grill (R. Vol. III, pp. 1495, 1585). The electric industry is making substantial inroads on this type of business. From Exhibit 186 (R. Vol. VII, p. 3725; Vol. IV, p. 2072), prepared by the Commission's witness Smith, it appears, in Schedule 1 (R. Vol. VII, p. 3727), that the average annual gas sales (M.C.F.) per customer for domestic use declined from 62.5 in 1929 to 53.6 in 1938, and that the average annual revenue per customer for domestic gas during the same period declined from $41.65 to $37.52. Exhibit 204 (R. Vol. VII, p. 3885, Vol.

IV, p. 2486) shows that in the electric field the per customer use of electricity in kilowatt hours increased from 499 in 1929 to 845 in 1938, and that the annual revenues per customer during the same period increased from $31.44 to $35.57. In the City of Chicago during the same period the per customer domestic gas sales decreased from 159.3 therms to 143.9 therms, and the annual revenues per customer decreased from $29.85 to $24.68 (Exhibit 202, R. Vol. VII, pp. 3877-3883, Vol. IV, p. 2482). Over the same period the Chicago electric utility experienced an increase in the per customer domestic consumption from 468 kilowatt hours to 863 kilowatt hours, and an increase in annual revenues from $25.50 to $33.42 (Exhibit 204, R. Vol. VII, p. 3885, Vol. IV, p. 2486). Schedule 1 of Exhibit 186 (R. Vol. VII, p. 3727, Vol. IV, p. 2072) shows that while there was a slight increase in the total per customer consumption of gas for commercial uses during the same ten year period, the revenue per customer had decreased from $102.64 to $98.93, indicating a material decrease in the unit price of gas for uses classified as commercial. The same exhibit shows that in 1929 the per customer consumption in the industrial field was 30,642.5 M.C.F. and that in 1939 the per customer volume had declined to 19,846.7 M.C.F., while the annual revenue per industrial customer declined from $6,170.52 in 1929 to $3,372.18 in 1938. These declines are unquestionably attributable to the circumstance that in the sale of gas for industrial purposes keen competition is encountered with coal, oil and other fuels (R. Vol. IV, pp. 2578-9).

7. *Danger of Increased Taxes and of Punitive Legislation.* While in their estimates for future operating expense summarized in Exhibit 117 (R. Vol. V, pp. 2819-39, Vol. II, p. 1068), cross-petitioners' witnesses projected the taxes through the period ending in 1954 on a basis of the levies or rates as they existed in 1939, it is a matter of common knowledge that we are just emerging (we hope) from the

worst depression in the history of this country, and that the expenses of running all branches of the government, from the national government down to the school district, have substantially increased during the period of the depression; that by reason of the inability of the citizenship to pay increased taxes commensurate with these increased expenditures large deficits have resulted; and that bonds and other evidence of indebtedness have been issued by the Federal government and by many of the local units of government. The situation manifestly presents serious danger of increased taxes (R. Vol. III, pp. 1578-9). The present defense program in this country has brought higher taxes. During the years 1932 to 1934, inclusive, cross-petitioners' taxes averaged about $340,300 a year. In 1935 their taxes had increased to almost double this average, and by 1937 they had increased to almost four times this average (Exhibit 116, p. 2, R. Vol. V, p. 2807, Vol. II, p. 1065).

It is a matter of common knowledge that there is widespread political agitation for the levying of greatly increased taxes on those who are in the business of extracting and marketing natural resources (R. Vol. III, pp. 1502-3). At every session of the Legislature of Texas in recent years strenuous effort has been made to increase the production taxes on natural gas by amounts varying from 100 to 1,000 per cent (R. Vol. I, p. 600). In the State of Illinois there has been no session of the Legislature in recent years but that bills have been introduced proposing the levy of taxes ranging up to as much as ten cents per M. C. F. on the sale of natural gas in that state. One of these bills, providing for a levy of five cents per M. C. F., actually passed the Senate (R. Vol. I, p. 601). The levy of a tax of five cents per M. C. F. would absolutely destroy cross-petitioners' industrial markets for natural gas, for the reason that the increase in price could not be passed on to the customer, who will pay only the

price justified by the competitive price of coal, oil and other available fuels. Indeed, this proposed tax in Illinois is not intended as a revenue measure but is punitive in character. It is well known that the coal miners, coal operators, coal dealers, railroad operators, railroad employees, and other organized groups take the position that the use of natural gas for industrial fuel cuts down the consumption of coal, thus reducing the demand for labor in the coal mines, on the railroads, and in the coal distributing establishments, and reacts on the revenues of the operators, the railroads, and the coal distributors (R. Vol. I, p. 600, Vol. III, p. 1503).

Directly related to this agitation, in all probability, is the suggestion embodied in the report by the Natural Resources Commission to the President, and by the President forwarded to Congress with his recommendation that it be given serious consideration. In this report the commission recommends that a Federal tribunal be set up with full power to control the use of coal, oil, natural gas and electricity to the end that the higher order of fuels, which doubtless would include natural gas, be reserved in the public interest for higher and more important uses and purposes, and that the lower orders of fuel be used for other purposes, such as the firing of boilers, in the interest of conserving the more desirable fuels. A bill to set up such a commission has been offered, and doubtless would receive the support of the organized interests above referred to, which are interested in limiting the fuel utilized by industry to coal and in excluding the use of natural gas as industrial fuel. It is manifest that the danger of this character of legislation, whether it involve an increase in taxes or a limitation of the use of natural gas, presents a serious menace to cross-petitioners' business.

8. *Danger of Increasing Costs of Regulation.* In Exhibit 117 (R. Vol. V, pp. 2819-2839, Vol. II, p. 1068) cross-petitioners' witness Campbell estimated that $30,000 a year

would be required after 1940 through 1950 to cover regulatory expenses. There is always the possibility of expensive proceedings before the Federal Power Commission if its right to regulate the prices at wholesale for natural gas be upheld. In this connection it must be remembered that regulation by the Federal Power Commission is not the only regulation to which cross-petitioners are subject. They are likewise subject to regulation by the Securities and Exchange Commission, by the National Labor Relations Board, and by the tribunal which administers the Wages and Hours Act; and their production activities are subject to regulation by the Railroad Commission of Texas. In the event of proceedings before any of these regulatory bodies $30,000 per annum would represent a small part of the cost. For some time legislation granting drastic powers to the Texas Railroad Commission has been urged upon the Texas Legislature, and in a recent session of the Legislature a bill was actually passed by the Senate conferring on the Railroad Commission authority to prorate and control the production from gas wells to the end that pipelines divide their market outlets with those who do not have markets (R. Vol. I, p. 580). If a valid act of this character were passed, cross-petitioners would be subjected to drastic increases in expenses and capital costs (R. Vol. I, pp. 580-1). They would be required to purchase gas at the prevailing field price, which now is about four cents per M. C. F. at the well, and in order to obtain this gas it would be necessary to build gathering lines to, and install meters at, numerous wells of others, some of which would doubtless be located at remote distances from cross-petitioners' gathering lines (R. Vol. I, p. 581). Eventually they doubtless would find it necessary to install field compressor units to boost the purchased gas into their gathering system (R. Vol. I, p. 532).

9. *Danger of Inflation.* The increased costs referred to in the preceding sections were primarily those incident to

the increased quantities of material and the increased volume of labor that would have to be purchased and employed in the adding of more capital facilities and a greater aggregate of replacements and maintenance than those assigned in the estimates summarized in Exhibit 117 (R. Vol. V, pp. 2819-39; Vol. II, p. 1068), which estimates are based upon prices of material and wages of labor obtaining on June 1, 1939. Among competent students of present economic conditions there is wide-spread sentiment that the country is faced with substantial increases in the price of commodities and with an attendant increase in the wages of labor (R. Vol. I, p. 449; Vol. III, pp. 1582-3). It is true that this danger confronts all industry and that such a situation would require that regulatory bodies re-examine existing rates. However, in view of the limited life of cross-petitioners' reserves, serious consequences might result from the inevitable delay that would attend any effort by them to obtain relief through regulatory processes.

10. *Danger of Varying Demand.* One of the most serious risks confronting cross-petitioners is the risk of losing substantial revenues over long or short periods due to variations in the demand for gas (R. Vol. I, pp. 571, 697). This danger has already manifested itself in the difference in the gross revenues as between the years 1937 and 1938 amounting to about $1,100,000 (Exhibit 136, R. Vol. V, p. 2959, Vol. III, p. 1393). This resulted in a decline in the net revenue in the amount of about $886,000 (Exhibit 136, R. Vol. V, p. 2959, Vol. III, p. 1393). In view of the fact that so much of cross-petitioners' revenues are received from the sale of gas used ultimately for industrial purposes (R. Vol. I, p. 584), cross-petitioners' business reacts immediately to and directly with fluctuations in the business conditions confronting the industries which utilize their gas (R. Vol. I, p. 584). Cross-petitioners are in an especially hazardous position on this point by reason of the fact that they sell their commodity at wholesale and have

no control over the policies affecting the sales to the ultimate consumer (R. Vol. III, p. 1583). The primary interest of the distributor is in its own earnings and not in the earnings of cross-petitioners. This is just as true of the three Chicago distributing companies which indirectly own a minority interest in the securities of cross-petitioners as of other distributors. Most of these distributors have standby equipment for the manufacture of artificial gas. Most of them continue to manufacture gas and blend it with the natural gas purchased from cross-petitioners before selling it to the ultimate consumer. Any conflict of interest between cross-petitioners and the distributing companies inevitably would be resolved by the latter against cross-petitioners without regard to any losses which cross-petitioners might sustain (R. Vol. III, pp. 1583-4). Cross-petitioners, therefore, are precluded from resorting to changes in policies and other means of protecting themselves against losses incident to business fluctuations or other circumstances resulting in varying demand for natural gas.

Evidence on Risks Offered by Complainant and the Commission.

The witnesses who testified for complainant and the Commission did not controvert the evidence of risks pointed out by witnesses for cross-petitioners. Three of their experts did not touch on the subject. Only Kleinman, called by complainant, testified concerning risks. In his direct testimony he did not mention any of the risks above pointed out; but he did undertake to discuss certain risks which he argued do not confront cross-petitioners, but do confront unregulated industries. In effect, he testified that a risk in business arises out of a decision which must be made by the management and which, when made, will affect the subsequent profits realized by the business (R. Vol. IV, p.

2082). Among the risks he mentioned as not applicable in any material degree to the operations of cross-petitioners were the risk of converting cash into inventory (R. Vol. IV, p. 2082), the risk of labor disturbances (R. Vol. IV, p. 2084), the risk of overhead expense connected with business (R. Vol. IV, p. 2084), the credit risk (R. Vol. IV, p. 2085), the risk of competition between rival concerns for the same market with the same product (R. Vol. IV, p. 2085), and the risk due to technological changes (R. Vol. IV, p. 2087). On his cross-examination the witness admitted that most of these risks confront cross-petitioners as well as others (R. Vol. IV, p. 2409); but he tried to minimize the importance of these risks as applied to cross-petitioners (R. Vol. IV, p. 2409). Called to testify in rebuttal (R. Vol. IV, p. 2558), Delafield, a witness for cross-petitioners, called attention to the tremendous inventory of natural gas which cross-petitioners acquired at a cost of more than $15,800,000 in the Texas Panhandle field, and to the fact that it will require some fifteen or twenty years from the date it was acquired to accomplish a turnover of this inventory. During this period, he pointed out, competing producers will be withdrawing gas from the same field, with the result that cross-petitioners have a distinct inventory risk against which they are more helpless than would be the owner of an inventory of manufactured articles or merchandise kept under lock and key controlled by the owner (R. Vol. IV, pp. 2574-5). He denied that cross-petitioners are without risk in connection with labor disturbances (R. Vol. IV, p. 2576), and pointed out that cross-petitioners employ some ten or twelve groups of men, one at each compressor station and one in the field, any one of which, were it to go out on strike, would put cross-petitioners completely out of business until the disturbances could be settled. He pointed out that, far from being without credit risks, cross-petitioners have taken a loss of more than $1,250,000 annually, since 1935, below the con-

tract price, as the result of a controversy arising between the complainant and Chicago District Pipeline Company (R. Vol. IV, p. 2578). He also testified to facts contradicting the testimony of Kleinman in claiming that cross-petitioners are not confronted with competition, pointing out in that connection that their keen competition with electricity, coal, oil and other fuels may be equally as disastrous as competition with another gas company (R. Vol. IV, pp. 2578-9).

The testimony of the four witnesses offered by cross-petitioners and the four witnesses offered by the Commission and complainant, relating specifically to the rate of return, will be discussed in the argument on that issue. pages 185 to 215 of this brief.

SPECIFICATION OF ERRORS.

In this brief we discuss the questions raised in the petition for the writ of certiorari (No. 265) as well as the questions raised in the cross-petition (No. 268).

The Commission and complainant in their petition for the writ of certiorari specified two questions as follows (Pet. 2):

> "1. Whether in issuing a rate order under the Natural Gas Act, the Federal Power Commission is required to include within the rate base a separate allowance for 'going-concern value';
>
> 2. Whether, in determining the annual allowance for amortization, the Commission may compute the allowance on the basis of the entire service life of the capital assets or only on the basis of the remaining life from the date of the passage of the Natural Gas Act, June 21, 1938, or from the date of the rate order."

In addition the Commission and complainant "reserved" the following question (Pet. 2, Ft. Note):

> "Whether, on judicial review of a rate order of the Commission under Section 19(a) of the Natural Gas Act, the order may be vacated for failure to make an allowance or adequate allowance for certain items of value or cost, in the absence of a finding that the rates permitted by the order are confiscatory, unjust, or unreasonable."

Cross-petitioners do not accept the foregoing statement of the questions as accurate presentations of the issues. On these matters cross-petitioners' contentions, broadly stated, are:

1. The decision of the Court below respecting going-concern value is sound. The Court below correctly held that the Commission's order should be set aside because it is confiscatory in that the Commission dis-

regarded going-concern value in fixing the rate base and in fixing the amount to be amortized;

2. The decision of the Court below respecting the period of amortization and the amount to be amortized and the amount of the rate base is sound. The Court below correctly held that the Commission's order should be set aside because it is confiscatory in that the Commission provided for the amortization of only the original cost of the properties and fixed the amortization period at the entire life of cross-petitioners' business, which commenced long prior to regulation;

3. The Court below found confiscation; but under the authority and duty imposed upon the Court below by Section 19(b) of the Natural Gas Act (15 U. S. C. 717 r(b)) the Court in *reviewing* an order under that section might set aside the order for reversible error, even in the absence of a finding of confiscation. This is not a case in the District Court in which the utility attacking rates fixed by a governmental body has the burden of showing confiscation to make out a case.

Cross-petitioners' contentions on the questions raised in their cross-petition are, broadly stated, as follows:

1. While the Court below did not pass upon the question, the Commission's order should be set aside on the ground that it is confiscatory in that it is based upon an interest rate of 6½% on the sinking fund;

2. While the Court below did not pass upon the question, the Commission's order should be set aside because there is no substantial evidence to support the Commission's finding that cross-petitioners' present rates are unjust or unreasonable. Under Section 5(a) of the Natural Gas Act (15 U. S. C. 717 d), the Commission has authority to fix new rates only after a proper finding, based upon substantial evidence, that the present rates are unjust and unreasonable;

3. The Court below erred in not sustaining cross-petitioners' contention that the Commission's order should be set aside because the Commission did not fix new rates as required by the Natural Gas Act;

4. The Court below erred in not sustaining cross-

petitioners' contention that the Commission's order should be set aside because it is confiscatory in that it denies cross-petitioners a fair rate of return;

5. The Court below erred in not sustaining cross-petitioners' contention that the Commission's order should be set aside because the Commission is without power and jurisdiction to enter an "interim" order;

6. The Court below erred in not sustaining cross-petitioners' contention that the Commission's order should be set aside because the Natural Gas Act, as applied by the Commission to cross-petitioners' business, is in conflict with the Fifth Amendment to the Constitution of the United States.

In addition cross-petitioners contend:

If this Court should reverse the judgment of the Court below and uphold the Commission's order, cross-petitioners should not be required to refund to their customers the amounts representing the ordered reduction in revenues which have accrued since the Commission's order.

SUMMARY OF ARGUMENT.

1.

The Court Below Found Confiscation; However, on a Judicial Review of a Rate Order of the Commission Under Section 19(b) of the Natural Gas Act, It Is Unnecessary for the Reviewing Court to Find That the Rates Permitted by the Order Are Confiscatory, Unjust, or Unreasonable in Order to Reverse; for It Is the Duty of the Reviewing Court to Vacate the Order If the Commission Committed Reversible Error in the Proceedings Leading up to the Order.

The Commission and complainant, in their petition for a writ of certiorari, in addition to the principal questions (respecting going concern value and period of amortization), "reserved for argument on the merits" the following question:

> "Whether, on judicial review of a rate order of the Commission under Section 19(a) of the Natural Gas Act, the order may be vacated for failure to make an allowance, or adequate allowance, for certain items of value or cost, in the absence of a finding that the rates permitted by the order are confiscatory, unjust, or unreasonable."

A reading of the opinion of the court below (R. Vol. VIII, pp. 4026-4041) shows beyond fair dispute that the court found that the Commission's order would result in confiscation because of the failure to make allowance, or adequate allowance, for certain items of value or cost. It is true that the court below did not enter findings of fact and conclusions of law such as are reqnired of Federal trial courts. But the court below did not, in this case, sit

as a trial court; it sat as a court of *review*, and carried out the duty imposed upon it by the Natural Gas Act, to-wit: to *review* of the Commission's order.

With respect to going concern value, the court below found that the Commission's failure to include this item of cost which cross-petitioners incurred in developing their properties into an operating concern was the taking of property without due process (R. Vol. VIII, pp. 4038, 4039). With respect to the period of amortization and the Commission's failure to use present value, including going concern value, in fixing the amount to be amortized and the rate base, the court below found confiscation. Indeed, on this point the court below said (R. Vol. VIII, p. 4040):

> "Avoidance of conflicts with the Fifth Amendment of the Constitution is involved. Petitioners' (cross-petitioners here) position avoids the conflicts; respondents' (Commission and complaint here) creates an unavoidable clash."

There is no doubt that the court below found confiscation. The court's conclusion that the Commission's order is confiscatory is clear from its opinion. Therefore, the question stated above as "reserved" by the Commission and complaint is, in fact, an academic and moot question on this record.

However, it is perfectly clear that the Natural Gas Act (Section 19(b)) confers on the court below the authority, and imposes on it the duty, to *review* the order of the Commission. The authority and duty of the court below and of this Court, under Section 19 of the Natural Gas Act, are essentially and fundamentally different from the authority and duty of a District Court in a rate case in which the regulated concern is the plaintiff attacking rates fixed by a governmental agency. In such a case, the plaintiff must allege and prove that the rates are confiscatory and violative of the Fifth Amendment or Fourteenth Amendment to the Constitution. In the absence of a show-

ing of confiscation by the plaintiff, the court, in the exercise of its equity powers, cannot disturb the rates. Here the authority and duty of the courts is to review and to set aside the Commission's order, if there be reversible error. Cross-petitioners had no burden before the Commission, had no burden in the court below, and have no burden here, to show that the Commission's order is confiscatory. Cross-petitioners have only the burden of showing reversible error. In fact, cross-petitioners have shown confiscation, and the court below found confiscation. Confiscation constitutes reversible error; but aside from confiscation, cross-petitioners are entitled to have the order vacated and set aside if they show that in the proceedings leading up to the order, and in the order, the Commission committed reversible error.

2.

The Court Below Correctly Held That the Commission's Order Should Be Set Aside Because It Is Confiscatory in That the Commission Disregarded Going Concern Value in Fixing the Rate Base and in the Amount to Be Amortized.

A. The Commission Erred in Refusing to Allow Cross-Petitioners' Claim of $8,500,000 *as Going Concern Value.*

B. In Any Event, the Commission Erred in Refusing to Allow Any Going Concern Value.

(*Infra*, pp. 68-101.)

The uncontradicted evidence shows that during the period of developing cross-petitioners' business the latter incurred out-of-pocket costs aggregating not less than $8,500,000, which costs will be entirely lost to cross-petitioners unless they are permitted to capitalize the same as going concern value to be included in the rate base and in the amount to be amortized. No effort is made here to capitalize past losses or to capitalize the speculative increase in value

of the properties subjected to public use. Cross-petitioners contend only that they should be permitted to capitalize necessary, proper, and reasonable costs actually incurred and paid during the period of development as an incident to putting their business on a going basis. These costs consisted of (1) actual contributions to sales campaigns and other promotional activities with a view of obtaining customers who would utilize the gas which cross-petitioners were in position to transport and deliver; (2) interest actually paid for money borrowed to acquire and install facilities to be held in readiness for use as the market outlets were expanded; (3) taxes actually paid on such facilities prior to actual use; (4) actual depreciation sustained on such facilities prior to their being put in use; and (5) operating expenses and maintenance costs incident to maintaining such facilities prior to their being put in use.

In fixing the rate base the Commission refused to allow these costs or any part of same as going concern value in addition to the value of the component parts making up the system as as whole. In fixing the amount to be amortized the Commission erroneously disregarded the present value of the properties and held that cross-petitioners are entitled to amortize only the original cost of their facilities; but in arriving at the original cost the Commission disregarded entirely the costs incurred as an incident to developing the market outlets to the original normal capacity of cross-petitioners' facilities.

City of Fort Smith v. *Southwestern Bell Tel. Co.*, 270 U. S. 627-28, affirming

Southwestern Bell Tel. Co. v. *City of Fort Smith*, 294 Fed. 102, 104-6.

McCardle v. *Indianapolis Water Co.*, 272 U. S. 400, 413, 415.

Omaha v. *Omaha Water Co.*, 218 U. S. 180, 202.

Des Moines Gas Co. v. *Des Moines*, 238 U. S. 153, 165.

3.

The Court Below Correctly Held That the Commission's Order Should Be Set Aside Because It Is Confiscatory in That the Commission Provided for the Amortization of Only the Original Cost of the Property and Fixed the Amortization Period at the Entire Life of Cross-Petitioners' Business, Which Commenced Long Prior to Regulation.

A. The Necessary Operation and Effect of the Natural Gas Act, If Valid, Is to Condemn to Public Use Cross-Petitioners' Property Utilized in the Conduct of Their Business, Which, Prior to the Enactment of the Act, Was a Strictly Private Business.

B. A Valid Administration of the Natural Gas Act Requires that Cross-Petitioners Be Compensated by a Proper Amortization Allowance for the Present Fair Value of Their Properties, Including Going Concern Value, as of the Time They Were Condemned for Public Use.

C. The Proper Period of Amortization Is that Beginning With Regulation Under the Natural Gas Act and Ending with the Life of Cross-Petitioners' Enterprise.

(*Infra*, pp. 102-129.)

At the time cross-petitioners' pipelines and facilities were constructed and acquired in the years 1930 and 1931 and at the time their operations began on January 1, 1932, cross-petitioners were engaged in a private business. Prior to the enactment of the Natural Gas Act they owed no duty to the public or to their customers to produce, transport and deliver natural gas at rates less than their negotiated charges. The enactment of the Natural Gas Act operated to subject cross-petitioners' properties to a public use. Such a taking is strictly analogous to, and equivalent to, a

condemnation of private property to public use. The public, acting through the governmental agency, must take cross-petitioners as it found them at the time of the enactment of the Natural Gas Act. Cross-petitioners are entitled, in addition to a reasonable return on the value of their property subjected to public use, to a return of that value through proper allowance for amortization over the period during which their property shall be subjected to public use.

It was not the cost of cross-petitioners' property, the principal part of which was incurred in 1930 and 1931, that the operation of the Natural Gas Act in effect condemned; but it was the property itself which cross-petitioners were using in the conduct of their business at the time the Act was passed that was condemned and subjected to public use.

The holding of the Commission that cross-petitioners be charged with amortization accruals, with interest thereon, from the first of January, 1932, more than six and a half years before the Natural Gas Act was passed, manifestly operates to deny to cross-petitioners a substantial part of the fair value of the properties condemned and subjected to public use as of the time the Act was passed, and thus to confiscate that proportion of such value represented by the assumed accruals for amortization, together with interest thereon, prior to the enactment of the Act.

The Fifth Amendment to the Constitution of the United States.

West v. *Chesapeake, etc., Tel. Co.*, 295 U. S. 662, 671.

United R. & E. Co. v. *West*, 280 U. S. 234, 253-4.

Spring Valley Waterworks v. *City of San Francisco*, 124 Fed. 574, 594-5.

4.

While the Court Below Did Not Pass on the Question, the Commission's Order Should Be Set Aside on the Ground That It Is Confiscatory in That, in Computing the Annual Allowance for Amortization by the Sinking Fund Method, the Commission Charged Cross-Petitioners Compound Interest on the Annual Installments at the Rate of 6½% Per Annum.

A. In Providing for Amortization the Commission Was Required to Allow Annual Installments for Accruals Out of Earnings Which, Added Together, Will Return the Proper Amount To Be Amortized by the Time Cross-Petitioners' Reserves of Gas Are Exhausted.

B. Under the Sinking Fund Method Adopted by the Commission, in Computing the Annual Allowance the Interest Rate Used in the Computation, Under the Uncontradicted Testimony, Must Be No Higher Than 2% Per Annum Compounded Semi-annually.

(*Infra*, pp. 130-144.)

The only justification for employing a sinking fund method of computing the annual amortization allowance is that cross-petitioners will receive an amount each year to apply on the total amount to be returned at the end of the amortization period, and that because the purchasers are paying annual installments on this obligation in advance they are entitled to be compensated in the rates for the use of the amounts returned from the time of payment to the end of the period. The question immediately arises as to what compensation the purchasers should be allowed on these installments. The issue is squarely drawn between cross-petitioners and the Commission. Cross-petitioners urged before the Commission and before the court that this compensation should be the interest at prevailing rates

obtaining on investments as nearly free from risk as can be obtained. Under the uncontradicted evidence this rate should not exceed 2% per annum, compounded semi-annually; but the Commission used 6½%. It fixed this rate on the theory that, if a rate of return of 6½% is fair and equitable for the company, by the same token it would seem to be fair and equitable in computing the amortization to be allowed. In other words, the Commission held that if cross-petitioners are entitled to a return of 6½% on the value of their reserves, pipelines, and other facilities, the purchasers are entitled to the same rate as interest on the amortization installments. This holding cross-petitioners attacked as erroneous and confiscatory.

United Fuel Gas Co. v. *Public Service Commission*, 278 U. S. 322, affirming

United Fuel Gas Co. v. *Public Service Commission*, 14 Fed. (2) 209, 211-12.

United Fuel Gas Co. v. *Railroad Commission*, 278 U. S. 300, 319.

Cheltenham & Abington Sewerage Co. v. *Public Service Commission*, 122 Pa. Sup. 252, 186 Atl. 149, 160.

5.

A. While the Court Below Did Not Expressly Pass on the Question, the Commission's Order Should Be Set Aside on the Ground That There Is No Substantial Evidence to Support the Commission's Finding That Cross-Petitioners' Present Charges Are Unjust and Unreasonable.

B. If by Implication It Overruled Cross-Petitioners' Contention on This Point, the Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because There Is No Substantial Evidence to Support the Commission's Finding That Cross-Petitioners' Present Charges Are Unjust and Unreasonable.

(*Infra*, pp. 145-166.)

There is a difference between a nonconfiscatory return and a reasonable return. Evidence of a barely nonconfiscatory rate of return is not evidence that a rate which yields a higher return is unreasonable. The effort of the Commission in this case has not been to set a reasonable rate, but a barely nonconfiscatory rate. Section 5(a) of the Natural Gas Act (15 U. S. C. 717d) gives the Commission authority to fix rates only after the Commission has found "that any rate, charge, • • • is unjust, unreasonable," etc. Such a finding must be based on substantial evidence. There is no substantial evidence in this record to support the Commission's finding that cross-petitioners' present charges are unreasonable. The only fact in any way bearing on the question is that cross-petitioners now earn $2,966,852 a year in excess of what the Commission deems to be a barely nonconfiscatory return on a rate base of $74,420,424. This one fact standing alone is clearly not substantial evidence that cross-petitioners' present rates are unreasonable. The Commission, in effect, held that a

barely nonconfiscatory return before amortization for cross-petitioners is $6,395,180 annually. In 1932 cross-petitioners' net earnings from operations before amortization and return amounted to only $3,665,594. In 1933 they amounted to only $4,106,544; and in 1934 to only $6,193,069. The average annual earnings for the first seven years have been only $7,629,298. This is only $1,234,118 per year above what the Commission regarded as a barely nonconfiscatory return. On the evidence accepted by the Commission, the revenues remaining for amortization and return over the whole period from 1932 to 1954, inclusive, at the present rates would be only $7,993,442 per year, which is only $1,598,262 per year in excess of the amount allowed by the Commission as barely nonconfisactory return.

The record does not support the Commission's finding that this excess is unreasonable; but, on the contrary, shows that the excess is reasonable on account of the great risks and hazards involved in cross-petitioners' business, past deficits and declining future returns, and the creative skill and efficiency of management in the conception, designing, construction and operation of cross-petitioners' facilities.

Wichita R. R. & El. Co. v. *Public Utilities Commission*, 260 U. S. 48, 57-9.

St. Joseph Gas Co. v. *Barker*, 243 Fed. 206, 213.

National Labor Relations Board v. *Abell Co.*, 97 Fed. (2) 951, 957.

6.

The Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because the Commission Did Not Fix New Rates as Required by the Natural Gas Act.

(*Infra*, pp. 166-174.)

Section 5(a) of the Natural Gas Act provides that whenever, after a hearing, the Commission finds that any rate is unreasonable, the Commission shall determine the reasonable rate and "shall fix the same by order." The Commission here did not fix by order the new rates at which cross-petitioners would be required to sell natural gas to their customers. The order merely required cross-petitioners to file new schedules of rates reflecting a reduction in their revenues to the extent of $3,750,000 annually. Obviously, the statute requires that the Commission shall determine the reasonable rates from substantial evidence. Cross-petitioners sell upon various bases to various types of users. They make a capacity charge and a number of different commodity charges based on the type of service. There is no evidence in this record upon which the Commission can determine what the various charges and rates should be for each type of service or for any type of service. The Commission has failed to carry out the mandate of the statute. A proper order, based upon substantial evidence, cannot be entered in the present state of the record.

Section 5(a) of the Natural Gas Act, 15 U. S. C. 717d.

Missouri, ex rel., S. W. Bell Tel. Co. v. *Public Service Commission*, 262 U. S. 276, 296-298.

7.

The Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because It Is Confiscatory in That It Denies Cross-Petitioners a Fair Rate of Return.

A. *There Is No Substantial Evidence to Support the Finding of the Commission That 6½% Per Annum on the Rate Base Allowed by the Commission Is a Fair Rate of Return for Cross-Petitioners.*

B. *Under the Evidence Submitted by Cross-Petitioners, Which Is Uncontradicted by any Subtsantial Evidence, Cross-Petitioners Are Entitled to a Rate of Return on the Rate Base Claimed by Them of Not Less Than 8% Per Annum.*

(*Infra*, pp. 175-215.)

The evidence on which the Commission relied in fixing the rate of return at 6½% per annum contradicts rather than supports the Commission's finding. There is no substantial evidence to support the finding. The rate of return allowed would not yield an amount sufficient to pay the actual cost, under the uncontradicted evidence, of refinancing cross-petitioners' properties through the issuance of new securities.

Bluefield W. W. & I. Co. v. *Public Service Commission*, 262 U. S. 679, 692.

Willcox v. *Consolidated Gas Co.*, 212 U. S. 19, 48-9.

Missouri, ex rel., S. W. Bell Tel. Co v. *Public Service Commission*, 262 U S. 276, 291.

8.

The Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because the Commission Is Without Power and Jurisdiction to Enter an Interim Order.

A. *The Power and Jurisdiction of the Commission to Fix Charges for Natural Gas Are Derived Solely from the Natural Gas Act.*

B. *By the Enactment of the Statute, Congress Neither Conferred Nor Intended to Confer on the Commission Power and Jurisdiction to Enter an Interim Order in the Midst of the Hearing.*

C. *The Order Entered by the Commission Under the Assumption That It Had Power and Jurisdiction Under the Statute to Enter an Interim Order Is Void.*

(*Infra*, pp. 216-234.)

Cross-petitioners were required to proceed with their testimony before the Commission and complainant were required to develop the testimony in support of their contention that cross-petitioners' existing rates are unjust and unreasonable. At the conclusion of cross-petitioners' *direct* testimony (before 30 of their 37 witnesses had been cross examined), the motion for interim order was filed with the Commission by complainant and counsel for the Commission. The hearing before the commission had not been concluded. Counsel for the Commission and complainant announced at that time that they would cross examine cross-petitioners' witnesses and then develop their testimony. We submit that the Natural Gas Act (Section 5) requires that the hearing be completed before an order reducing rates can be entered. Cross-petitioners have not had such a full hearing. Since there is no provision in the statute for entering an interim order, and, under the plain

wording of the statute, the Commission has authority only after a complete hearing to enter an order fixing rates, the present order is clearly beyond the commission's jurisdiction.

Interstate Commerce Commission v. *L. & N. R. R. Co.*, 227 U. S. 88, 91-3.

Ohio Bell Tel. Co. v. *Public Service Commission*, 301 U. S. 292, 298-300.

Wisconsin Tel. Co. v. *Public Service Commission*, 287 N. W. 122, 133-8 (Sup. Court Wis.).

9.

The Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because the Natural Gas Act, as Applied by the Commission to Cross-Petitioners' Business, Is in Conflict With the Fifth Amendment to the Constitution of the United States.

A. *The Regulation Imposed Is Violative of the Fifth Amendment Because Cross-Petitioners' Business Is Not Affected With a Public Interest and Not Subject to Price Regulation.*

B. *The Regulation Imposed Is Violative of the Fifth Amendment Because It Involves a Taking of the Use of Cross-Petitioners' Property for the Public and Prohibits Cross-Petitioners from Withdrawing Their Property from Such Use Except by Permission of the Commission.*

(*Infra*, pp. 234-254.)

Cross-petitioners do not transport gas through their pipeline for hire. They are not a common carrier.

Cross-petitioners are not a public utility. They do not hold themselves out to sell gas to anyone who may apply. They sell gas only to selected customers upon negotiated terms and prices.

They are not public servants. Their business is purely private. The fact that they sell in part to public utilities does not constitute them a public utility. Natural gas is only one of a number of commodities and articles that the public utilities use in their business of furnishing service to their retail consumers. The purchasing utilities also use pipelines, pumps, engines, automobiles, adding machines, typewriters, stationery, pencils, and hundreds of other items. The fact that natural gas is a commodity which is useful to the public does not render cross-petitioners a public utility because they sell that commodity to utilities which hold themselves out to serve the public with natural gas. Gasoline, theater tickets, food, etc., are commodities useful to the public; but the courts have held that purveyors of such commodities are not subject to price regulation.

The taking of the use of private property and prohibiting the owners from the withdrawing of that property from such use except by permission of a regulating tribunal was held unconstitutional in the Wolff Packing Company case, cited below. The regulation here attempted is unconstitutional, regardless of whether cross-petitioners' business is affected with a public interest.

Williams v. *Standard Oil Company*, 278 U. S. 235, 239-40.

New State Ice Co. v. *Liebmann*, 285 U. S. 262, 277.

Wolff Packing Co .v. *Court of Industrial Relations*, 262 U. S. 522, 534, 536-7, 539-44.

Union Falls Power Co. v. *City of Oconto Falls*. 265 N. W. 722, 723 (Supreme Court Wis.).

10.

If This Court Should Reverse the Judgment of the Court Below and Affirm the Commission's Order, Cross-Petitioners Should Not Be Required to Refund to Their Customers the Amounts Representing the Ordered Reduction in Revenues Which Have Accrued Since the Commission's Order.

A. *No Public Interest Will Be Served by Requiring Cross-Petitioners to Pay Over to Their Wholesale Customers the Very Substantial Sums of Money Involved in Such a Refund; Which Amounts the Purchasing Utilities Have Contracted to Pay Cross-Petitioners and Which, If Refunded to Them, Such Purchasing Utilities Could Not Be Required by State Regulatory Bodies to Pass on to Their Customers.*

B. *The Existing Rates Are Valid and Enforcible Until the Commission Shall Determine the Just and Reasonable Rates and Fix the Same By Order; and Even If the Court Below Correctly Held That the Commission Could Require Cross-Petitioners to File a New Schedule of Rates Effecting the Reduction Ordered, Such New Rates Could Not Be Made Retroactive But Would Become Effective Only When Constituted the New Rates By Order of the Commission.*

(*Infra*, pp. 260-264.)

This proposition and its subdivisions constitute a summary of the argument supporting the contention raised.

ARGUMENT.

I.

The Court Below Correctly Held That the Commission's Order Should Be Set Aside Because It Is Confiscatory in That the Commission Disregarded Going Concern Value in Fixing the Rate Base and the Amount to Be Amortized.

A. *The Commission Erred in Refusing to Allow Cross-Petitioners' Claim of $8,500,000 as Going Concern Value.*

B. *In Any Event, the Commission Erred in Refusing to Allow Any Going Concern Value.*

(Sec. 2, Summary of Argument, *supra*, p. 54.)

The statement (p. 2) and discussion (pp. 9-12) by the Commission and complainant in their petition to this Court for a writ of certiorari on the issue of going concern value correctly presents neither the question nor the record. They assert (p. 2) that the question is whether a *separate* allowance must be made for going concern value. They assert also (p. 9, footnote 5) that the Commission appraised the physical assets "as part of an assembled whole" (which is inaccurate) and that the court below required a separate allowance for going concern value (which is inaccurate). The court below properly held, among other things, that the Commission did not value the property as a going concern, but only as inert property, and that the Commission erred in allowing no going concern value (R. Vol. VIII, p. 4039).

The Commission and complainant in their petition to this Court do not raise or challenge the elementary proposition that going concern value, where proved, is property, which may not be taken without due process. The petition

does not specify for review any question as to cross-petitioners' proofs of going concern value or the amount (not less than $8,500,000) which cross-petitioners claim, and which the court below found proper (R. Vol. VIII, p. 4039). Finding themselves in no position to attack this evidence, which is uncontradicted, the Commission and complainant seek here to avoid meeting the evidence by asserting (p. 9, footnote 5) that the going concern value was considered by the Commission in appraising the physical assets "as part of an assembled whole." They assert also (pp. 9-10) that the going concern allowance approved by the court below was calculated on the basis of interest and return, assumed to have been unearned in the past, and other deficiencies in past earnings, previously included in operating expenses during the period of business development, asserting further that this is a method which this Court has specifically condemned (p. 10).

The assertion of the Commission and complainant (p. 9, footnote 5) that the Commission's valuation includes going concern value is conclusively refuted by the record.

(a) The Commission *accepted* the testimony of cross-petitioners' witnesses as to reproduction cost new of the physical properties and as to the value of the gas reserves (R. Vol. VIII, p. 3936). Nowhere in their petition to this Court do the Commission and complainant mention the fact that cross-petitioners' witnesses who testified as to the value of the physical properties did not place a value on such properties as a going concern (R. Vol. II, pp. 1236, 1276; Vol. III, p. 1355). These witnesses testified as to the reproduction cost new of each item (R. Vol. II, pp. 1191-1276). They did not value the properties as a going concern or "as part of an assembled whole" (R. Vol. II, pp. 1236, 1276; Vol. III, p. 1355). They expressly excluded the intangible or going concern value in the figures submitted (R. Vol. II, pp. 1236, 1276; Vol. III, p. 1355).

(b) The Commission also accepted cross-petitioners' evidence as to capital additions from June 1, 1939, to December 31, 1942, and as to working capital (R. Vol. VIII, pp. 3936-7). From the four items (1) reproduction cost new of the physical properties, (2) value of the gas reserves, (3) capital additions, and (4) working capital, the Commission made up the rate base (R. Vol. VIII, p. 3937). *Not one of these items included any going concern value.*

(c) The Commission flatly rejected cross-petitioners' claim for going concern value, and so stated in its opinion (R. Vol. VIII, pp. 3936-7).

(d) The court below correctly interpreted the Commission's opinion in holding that the Commission made no allowance for gong concern value. In its opinion the court below said (R. Vol. VIII, p. 4039):

> "The Commission argues that in fixing the value of the rate base as high as $74,420,424, it gave full recognition to petitioners' business as a going business concern. This statement is contrary to the memorandum filed by the Commission with its findings. The $74,420,424 was made up of—
>
> | | |
> |---|---|
> | Reproduction Cost New of Physical Properties | $56,302,250 |
> | Value of Gas Reserves | 13,334,775 |
> | Capital Additions for the Period June 1, 1939 to December 31, 1942 | 3,808,399 |
> | Working Capital | 975,000 |
> | Total Rate Base | $74,420,424 |
>
> "The total is the amount which the Commission adopted as its rate base. It does not include going value.
>
> "Moreover, in its opinion, the Commission said, 'The Companies' claim of $8,500,000 for going concern value must be disallowed. The amount obviously is an arbitrary claim, not supported by substantial evidence warranting its allowance. Its allowance would mean the acceptance of a deceptive fiction resulting in an unfair imposition upon consumers.'

"In the face of this statement we must assume that the Commission did not allow any sum for going value."

(e) The Commission and complainant assert (p. 9, footnote 5) that there is "ample evidence that the rate base adopted did and was intended to reflect the value of the physical property 'as part of an assembled whole.'" Two items of this alleged "ample evidence" are stated in the same footnote. The first is, "• • • the Commission's adoption, as its basis of valuation, of respondents' estimate of reproduction cost, which was $13,500,000 in excess of the original investment (R. 3937) and which included, in addition to labor and material costs, large allowances for overheads, such as interest, taxes, and administrative, legal, supervisory and 'preliminary operations' (R. 1224-1231, 1234) • • •". Two answers to this claim are apparent.

In the first place, cross-petitioners' estimate of reproduction cost, which the Commission accepted, was not $13,500,000 in excess of the original investment in the properties covered by the reproduction study. The reproduction cost figures were prepared as of June 1, 1939 (Exhibit 142, p. 1; R. Vol. II, p. 1414). The capital expenditures, excluding gas reserves, as of January 1, 1939, amounted to $49,830,479 (Exhibit 141, p. 2, line 19; R. Vol. III, p. 1411). The estimated cost of additional capital expenditures for 1939 was $856,558 (Exhibit 141, p. 2, line 22; R. Vol. III, p. 1411). The estimated cost of additional property from June 1, 1939, to the end of that year was $662,658 (Exhibit 142, p. 2, line 22; R. Vol. VIII, p. 1414). Thus it appears that the total expenditures for capital facilities as of June 1, 1939, amounted to $50,024,379. The reproduction cost new figure adopted by the Commission for the physical properties, exclusive of gas reserves, as of June 1, 1939, was $56,302,250. Thus it appears that the figure adopted amounted to only $6,277,871 in excess of the origi-

nal investment in the physical properties other than leaseholds.

However, in figuring the original cost of cross-petitioners' properties it is unfair to include the original cost of the physical properties alone; for, as we shall point out later in this brief, cross-petitioners incurred actual costs aggregating $8,500,000, *after they commenced operations*, in developing their markets ffom the small quantity (60,000 M. C. F. daily), with which they commenced business, up to the original normal capacity, which put their operations on an earning basis. Also, the original cost of the leasehold interests aggregated as of January 1, 1939, $15,893,513.08 (Exhibit 138, p. 2, line 21; R. Vol. V, p. 3007; Vol. III, p. 1397). The Commission allowed only $13,334,775 as the value of the gas reserves. The allowance for the physical properties, including gas reserves, therefore, aggregated $69,637,025. The original cost of the other physcal properties the leaseholds and the going concern value amounted to the sum of $50,024,379, $15,893,513.08, and $8,500,000, a total of $74,417,892.08; so it appears that, instead of allowing in the rate base on account of existing properties $13,500,000 more than the original cost of the property subjected to public use, the Commission allowed $4,780,867.08 less than its original cost.

In the next place, the Commission *accepted* cross-petitioners' reproduction cost estimate as to the fair value (R. Vol. VIII, p. 3936); and, as already pointed out, that reproduction cost estimate did not include going concern value. To point out that the fair value found by the Commission from the reproduction cost new figures is more than the original investment in the properties does not show that the fair value found by the Commssion includes going concern value. To determine what the fair value as found by the Commission includes, it is necessary to con-

sider what the Commission *did*. What the Commission did is clear from the language of the court below quoted in Subdivision (d) above.

The reference by the Commission and complainant in their petition to this Court to the fact that the Commission's finding as to fair value of the inert physical property "included, in addition to labor and material costs, large allowances for overheads," etc., is a misleading statement of the record. The statement implies that these "overheads" and other items were allowed as costs of attaching business to inert property. That is not true. Those "overheads" and other items were *costs incurred during the period of construction* (R. Vol. II, pp. 1224-31). Cross-petitioners' claim for going concern value is based upon proved costs of attaching business *after the period of construction* (R. Vol. II, p. 1278; Vol. III, p. 1329). These costs, as proved, were found proper by the court below (R. Vol. VIII, p. 4039) and are unchallenged in the petition of the Commission and complainant for writ of certiorari.

The second item of "ample evidence" referred to in the same footnote is, "• • • the Commission's declaration, in rejecting the companies' claim for a separate allowance for 'going concern value,' that the rate base included 'more than an adequate amount to cover all elements of value' (R. 3936-3937)." This is not a statement that going concern value was included. That the Commission did not regard going concern value as a proper "element of value" is manifest from the preceding language of the Commission that "the companies' claim of $8,500,000 for going concern value must be disallowed • • •." Further, the statement of the Commission that it was convinced it was allowing in the rate base more than an adequate amount to cover all elements of value manifestly does not overcome the uncontradicted fact that the Commission accepted cross-petitioners' reproduction cost estimate,

which did not include going concern value, and expressly rejected cross-petitioners' claim for going concern value, as already pointed out. The statement by the Commission of what it was doing at the time it wrote its opinion cannot be reconciled with what it and complainant now say it did.

A serious misstatement of the record appears in the petition to this Court by the Commission and complainant (pp. 9-10). They there state, "The going concern allowance approved by the court below was calculated on the basis of interest and return assumed to have been unearned in the past and other deficiencies in past earnings, previously included in operating expenses, during the period of business development (R. 1276-1282; 1327-1337; 2943-2947), a method which this Court has specifically condemned. *Galveston Elec. Co.* v. *Galveston*, 258 U. S. 388, 393-397; *Columbus Gas & Fuel Co.* v. *Public Utilities Commission*, 292 U. S. 398, 411-413." By this inaccurate statement the Commission and complainant here seek to bring cross-petitioners' claim for going concern value within the rule laid down in the *Galveston* case, that the cost of developing an "operating" plant into "a financially successful concern" is not allowable as going concern value. The evidence supporting the claim here presented is not based on any such cost. The evidence is the actual cost of putting cross-petitioners' plant *into operation*. This character of cost has been expressly upheld by this Court in *City of Fort Smith* v. *Southwestern Bell Tel. Co.*, 270 U. S. 627, 628, as we shall point out later in this brief.

The record shows conclusively that the witnesses who testified to the value of the physical properties did not include in those values the intangible or going concern value. In presenting the reproduction cost new of the physical properties other than leases, the witnesses took all physical property--pipelines, compressor stations, buildings, etc.—and established the cost of reproducing those units,

without including anything except the costs of the inert property at the time of completion, before seasoning and before it had business attached (R. Vol. II, pp. 1236, 1276). One of these witnesses, Hamilton, testified also to the going concern value of the property as separate and distinct from the value of the physical property, to which he had already testified (R. Vol. II, p. 1276). The witness Wallace, who testified to the value of the leaseholds, made it equally clear that he was not valuing the property as a part of a going concern (R. Vol. III, p. 1355). Since the Commission adopted the figures of both these witnesses, there can be no claim here that, in arriving at the values based on the figures adopted, the Commission took into account the element of going concern value.

The witness Hamilton, an engineer of wide and long experience in dealing with such matters (R. Vol. II, pp. 1191-4), testified in substance that there is a going concern value attaching to the property of cross-petitioners in addition to the value of the component physical parts which go to make it up; that by going concern value he meant a value to be assigned to the property *over and above the cost of its physical property because of the fact that it has made the necessary expenditures and sacrifices to get a business attached;* that cross-petitioners have attached this business and have built the income up to a paying basis; that *the cost entering into this going concern value came after the construction of the physical property,* and created an item of value; that cross-petitioners' pipeline without customers and without business was something entirely different from the same pipeline with its customers attached, and doing business with an operating organization seasoned and familiar with their jobs and with the low operating costs resulting from the employment of that kind of an organization (R. Vol. II, p. 1276).

He continued that when a pipeline is built into a town it is necessary to supplant other fuels which the potential

customers are then using, namely, coal, oil, or some other fuel; that, even though the cost of gas is comparative, the pipeline is nevertheless confronted with the reluctance of customers to throw away their investment in the equipment they are using and provide other equipment in order to use natural gas (R. Vol. II, p. 1277). He made a study of the items of cost incurred by cross-petitioners during the period when they were engaged in building up the load from its small beginning to the level attained by the end of 1935, when for the first time the pipeline became fully loaded up to its original capacity. He then took the figures for the years 1936, 1937 and 1938, over which the pipeline had been operated after being loaded, and found that the average result in terms of gross revenues for the three years was $14,847,112 (R. Vol. II, p. 1278). This revenue was earned, however, after the rated capacity of the pipeline had been increased from the original 175 million cubic feet daily to 210 million cubic feet. During the period up to the latter part of 1935 the capacity of the line had been only 175 million cubic feet daily. On that capacity basis, therefore, the normal revenues during the load building period would have been $12,372,593, or 175/210 of the average revenues for the three year period after the line became loaded (R. Vol. II, p. 1278). He then showed that in the year 1932, the first year of operation, the revenues were only 47.3% of $12,372,593; in 1933, only 50.5% of that amount; in 1934, 76.7% of that amount; and in 1935, 97.3% of that amount. From these figures he determined that during 1932 52.7% of the facilities provided by cross-petitioners was standing idle awaiting the time when the load would be developed to the point where the full facilities would be utilized; and in 1933, 49.5% of the facilities was standing idle; in 1934, 23.3%; and in 1935, 2.7% was still standing idle (R. Vol. II, pp. 1278-9).

Hamilton explained that in the construction of a pipeline system it is economical to build the pipeline for the

ultimate capacity for which it is designed, and that it is impractical and uneconomical to resort to piecemeal construction of a pipeline system. He illustrated his point by the observation that it would have taken an 18 inch line to carry 50% of the load which a 24 inch line was capable of handling, and that in rights of way and many other items the smaller line would have cost the same as a 24 inch line (R. Vol. II, p. 1279). From this testimony it is easy to see that had the pipeline been built in the beginning for just the load that it had during 1932, cross-petitioners would have had to build another 18 inch line by the beginning of 1934, during which year the load was built up to 76.7% of the capacity of the 24 inch line. The practical, economical thing, therefore, from the standpoint of cross-petitioners' overall investment, and from the standpoint of those to be served by the pipeline, was to design and build the pipeline and facilities and hold them in readiness to serve the load as rapidly as it could be developed, rather than to make the uneconomical capital additions that otherwise would have been required as the load increased.

The record shows without contradiction that the costs of the reserves and facilities were paid with borrowed money and by the assumption of certain interest-bearing notes executed and delivered as a part of the purchase price for gas reserves (R. Vol. II, p. 1279). For this borrowed money bonds aggregating $60,000,000 were executed by cross-petitioner Natural Gas Pipeline Company of America to the lenders, payable over a period of fifteen years (Exhibit 137, p. 1; R. Vol. V, p. 2991; Vol. III, p. 1394; Vol. III, p. 1681).

Hamilton called attention to this indebtedness and pointed out that cross-petitioners knew that it would be a few years before the project could acquire business sufficient to put the facilities to full utilization, and that they knew also that it would be necessary to spend large sums of money on sales promotion, both directly and by con-

tributions to their purchasers who were to resell the gas at retail (R. Vol. II, p. 1279). He explained that since the facilities were built with funds on which cross-petitioners were paying interest during the load building period, a portion of these interest payments represented actual costs of providing those facilities in advance of utilization (R. Vol. II, pp. 1279-80). He then pointed out that there were other costs, such as taxes, depreciation, and fixed operating charges not varying with the volume of business handled, which were attributable to the unused portion of the facilities during the load building period (R. Vol. II, pp. 1279-80). He found that during the load building period, 1932, 1933, 1934, and 1935, cross-petitioners made actual payment of interest on its bonds and notes in the respective sums of $3,666,350, $3,625,079, $3,598,392, and $3,474,732; and he rightfully concluded that 52.7% of the interest paid in 1932, 49.5% of the interest paid in 1933, 23.3% of the interest paid in 1934, and 2.7% of that paid in 1935, aggregating $4,658,809, was interest paid out of pocket in order to provide in advance facilities which were not actually utilized during the load building period (R. Vol. II, p. 1280).

By the same reasoning he determined that of the *ad valorem* taxes applying to the property itself, without including income taxes or taxes of that character, during the same four year period of load building, $379,185 was paid on facilities standing idle awaiting the development of the load (R. Vol. II, p. 1280).

Next he took the figures of the witness Biddison, who testified as to actual depreciation occurring to June 1, 1939, aggregating $2,866,758, which figures and the supporting testimony stand uncontradicted in the record, and, for the purposes of his computation, assumed that this depreciation had occurred at a uniform rate during the eight year period since construction (R. Vol. II, p. 1280). By the same reasoning used in connection with computing the in-

terest and taxes paid out, he arrived at a figure of $358,345 as representing the average actual annual depreciation on cross-petitioners' facilities. Correcting that figure to apply only to facilities in use during the load building period, he found that the actual annual depreciation sustained on the facilities provided in advance of utilization was $298,621 (R. Vol. II, p. 1280). Applying the same percentages as those applied to the interest and tax payments for each of the four years, Hamilton determined that the sum of $382,832 represented the cost to cross-petitioners in terms of actual depreciation of facilities standing idle during the load building period (R. Vol. II, p. 1281).

Next he explained that certain expenses are fixed and do not vary in proportion to the quantity of gas handled and that certain officers' salaries do not go up or down with the load (R. Vol. II, p. 1281). Certain other expenses do vary almost directly in proportion to the quantity of gas handled, and, naturally, during the development period these latter expenses were much lower than in subsequent years when full capacity of the line was being utilized (R. Vol. II, p. 1281). Without making detailed analyses, he considered that general and administrative expenses, pipeline maintenance expenses and telephone expenses were fixed and that a certain portion of those expenses was attributable to the system's nonproductive capacity during the load building period. In other words, these particular items of expense, according to the witness, would have been no greater had the pipeline been loaded to capacity, the pipeline being so manned and equipped that the cost of items of that character necessary to handle the reduced volume of gas would continue to meet those charges when the lines were loaded. He therefore applied the same percentages to the non-varying operating charges for the four years of load building period, arriving at a total of $1,243,366 of operating expenses attributable to the facilities standing by and waiting to be loaded (R. Vol. II, p. 1281).

He found from the companies' books (R: Vol. II, p. 1281) that since the completion of the project cross-petitioners had made direct expenditures for the sole purpose of attaching business, which they afterwards continued to enjoy, of substantial sums of money during the four years of load building period. These moneys were actually paid out in advertising and other promotional activities and as contributions to purchasers to be used in the same character of activities, and amounted to $1,567,372 during the four year period (R. Vol. II, p. 1282).

Adding the amounts actually paid out as interest, as taxes, as non-varying operating costs, the amount sustained as actual depreciation on account of facilities awaiting utilization, and the amount actually paid out directly in promotional activities, he arrived at a total of $8,231,564 (R. Vol. II, p. 1282). Hamilton pointed out that the sum just stated did not include all of the costs of attaching business; that there had been omitted from these calculations any cost incident to the seasoning of the plant and any cost for assembling and training the operating personnel. He then testified that in his judgment the properties of cross-petitioners had a going concern value in excess of the inert or bare physical properties of at least $8,500,000 (R. Vol. II, p. 1282).

Another witness, Emery, testified from the same basic cost figures. He had not seen Hamilton's figures and was not familiar with Hamilton's approach in applying the basic cost figures to the going concern value (R. Vol. III, pp. 1338-9). His approach to the determination of the idle capacity differed from Hamilton's approach in that he arrived at the percentage of the total rated capacity of the facilities not being used during the years 1932, 1933, 1934 and 1935 by a study of the volumes handled during the load building period rather than the revenues derived from the sale of those volumes (R. Vol. III, p. 1330). He ascertained that during the three years following the load-

ing of the line cross-petitioners maintained an annual load factor of 92.48% of the total rated capacity of the line, which during that time was 210 million cubic feet daily (R. Vol. III, p. 1330). Applying that annual load factor of 92.48% to the rated capacity of the line during the load building period, which was 175 million cubic feet daily, and then comparing the result with the load actually transported through the line during each of those four years, Emery found that of the total normal capacity 51.98% was unused during the year 1932, 56.75% was unused in 1933, 21.42% was unused in 1934, and 3.63% was unused in 1935 (R. Vol. III, p. 1330). It is interesting to note that the percentage of lag for each of the four years as determined by Emery from comparison of volumes handled corresponds very closely with the percentage reached by Hamilton through his approach from comparison of revenues.

Applying these percentages, at which he had arrived by the approach above stated, to the same items of cost used by Hamilton in his computations, Emery found that interest was paid out on borrowed funds invested in facilities provided in advance of utilization in the sum of $4,859,896; that *ad valorem* taxes were paid on unused facilities during the same period in the amount of $396,489; that non-varying operating expenses attributable to this same idle capacity were paid during the same period in the sum of $1,226,818; and that depreciation sustained by that part of the facilities representing capacity not utilized during the period amounted to $517,099, which sums added to the $1,567,791 actually paid out in soliciting business aggregated $8,568,093 (R. Vol. III, p. 1334). The witness testified that the properties of cross-petitioners had a going concern value, in excess of the value of physical properties, of not less than the amount last stated (R. Vol. III, p. 1337).

Emery testified also that cross-petitioners had incurred

other expenses in connection with the building up of the load and putting the business on a going basis (R. Vol. III, pp. 1334-6). These expenses included those incident to the building up of the organization and training the personnel of the organization in their duties, which represented both a substantial cost and a substantial value from the standpoint of cross-petitioners (R. Vol. III, pp. 1334-6). He also testified that the assembling, organizing and developing of a system of accounting and procedure represented a substantial cost and a substantial value (R. Vol. III, pp. 1334-6). He did not reduce those costs or elements of value to terms of dollars for the reason that he found it difficult to determine in terms of dollars just what the cost of assembling and training the organization and of developing cross-petitioners' system of accounts, forms and procedure had been (R. Vol. III, pp. 1334-6). In stating his conclusion as to the amount of going concern value he considered, therefore, just those items of out of pocket cost that he could definitely ascertain in terms of dollars from the records of cross-petitioners (R. Vol. III, pp. 1334-6). He testified that it would cost as much, if not more, to reproduce all the elements to which he had testified as making up the going concern value, as well as the elements not included therein, as the costs originally incurred in this connection (R. Vol. III, p. 1337).

On this subject Floyd C. Brown, general manager of cross-petitioners, testified at considerable length as to the character and ability of the personnel, the cost in time and money (without stating this cost in terms of dollars) of organizing and training the personnel, and the very substantial value to the organization of this trained personnel (R. Vol. III, pp. 1311-23; Exhibit 129, R. Vol. III, p. 1323; Vol. V, p. 2927).

We submit that there is no difference in principle in allowing a regulated company to capitalize interest, taxes,

administrative expenses, and similar items incurred *during* the period of construction and in allowing cross-petitioners to capitalize the items submitted as making up the costs of their going concern value. The underlying reason, universally recognized and applied, for allowing interest, taxes, etc., during construction is that the owner has his money tied up during a period when he is not able to obtain an earning on it, and that it is proper and right to allow him to capitalize his out-of-pocket costs during that period so that he may earn compensation thereon after he puts his business in operation. Manifestly, in a case such as that presented here, where the owner on putting his business in operation still had approximately half of his facilities standing idle during the first two years, a fourth of them standing idle during the third year, and a percentage of them still standing idle in the fourth year, he is in exactly the same situation as to the idle capacity which is waiting to be put into use as he was with reference to all of his facilities during the period of construction. The Commission and complainant do not contest the right of cross-petitioners to capitalize interest, taxes, and similar items incurred during the period of construction. They impliedly admit that these items were properly capitalized in their petition to this Court (p. 10), in which they point out that such items were allowed by the Commission. It seems clear that the same reasoning which entitles the owner to have them allowed when incurred *during the period of construction* entitles him to have them allowed when incurred in carrying idle capacity *waiting to be put in use* after the business has been put in operation on a partially developed basis.

The uncontradicted testimony presented by cross-petitioners in support of this claim, all of which was based on historical facts established by the records of cross-petitioners' business, cannot be brushed aside by the Com-

mission with the statement that it must be disallowed because it is an arbitrary claim and its allowance would mean the acceptance of a "deceptive fiction" (R. Vol. VIII, p. 3936). The figures are based on the facts. They are definite. They are certain. They represent the actual historical cost of acquiring this going concern value, which is a real and not a fictitious item of value.

There is no similarity between the items of cost here submitted and the theoretical losses claimed and condemned in the case of *Galveston Electric Co.* v. *Galveston*, 258 U. S. 388, cited by the Commission and complainant in support of their claim that this item of going concern value should not be allowed. The distinction between the facts in the *Galveston* case and those involved here is clearly set out in *Southwestern Bell Telephone Co.* v. *City of Fort Smith*, 294 Fed. 102, 104-6. In that case counsel for the City, like counsel for the Commission and complainant in this case, were relying on the *Galveston* case as authority for denying the claim of the company for going concern value. The facts on which the telephone company relied as the basis of its claim were exactly the same in character as those on which cross-petitioners base their claim in the case at bar. They included cost of attaching business, cost of training employees or building up organization, cost of records and administration, cost of maintenance and depreciation on idle plant, and interest and taxes on idle plant *after commencement of operations*. The trial court in that case so aptly expressed the claims and distinctions which we are here trying to make that we feel justified in quoting at length from that case, particularly since this court affirmed the judgment of the trial court in that case:

> "The city relies upon the decision in the case of *Galveston Electric Co.* v. *City of Galveston, et al.* * * * In that case Mr. Justice Brandeis, speaking for the court, said:
>
> "'The going concern value for which the master

makes allowance is the cost of developing the operating railway system into a financially successful concern. The only evidence offered, or relied upon, to support his finding is a capitalization of the net balance of alleged past deficits in accordance with what was said to be the Wisconsin rule.'

"After discussing the items taken into consideration by the master in arriving at going value, Mr. Justice Brandeis said:

"'Going concern value and development cost, in the sense in which the master used those terms, are not to be included in the base value for the purpose of determining whether a rate is confiscatory.

"(1) The opinion in that case does not sustain the contention that going value should not be considered in a rate case. The decision in the case of *Des Moines Gas Co.* v. *Des Moines* was neither modified nor overruled by the decision in the *Galveston* case. The conclusion must be that going value is a proper element to be considered in a rate case. It is proper to state that this conclusion is opposed to the conclusion in the case of *Jacksonville Gas Co.* v. *City of Jacksonville* (D. C.), 286 Fed. 404.

"The valuation engineer of the plaintiff prepared and introduced an exhibit in which he stated how the cost of establishing the business was arrived at, as follows:

"'In order to determine the going concern value of the plant at Ft. Smith, a detailed estimate of the cost of establishing the business has been made; in other words, the cost of putting the dormant physical plant into active going condition. This estimate covers only those costs incident to establishing the business, such as attaching the subscribers; training the organization necessary for the proper handling of the business; preparing the records necessary for conducting the business; maintenance and depreciation on the idle plant from the time of completion of various elements of plant until put into service; and taxes and interest on the idle plant after the exchange opens until all the plant is in service. This estimate of the cost of establishing the business, or making a going concern out of

a dead physical plant, does not duplicate any portion of the cost of reproducing the physical property or any other costs included in the appraisal, and is predicated on the following:"

The court then referred to the various premises upon which the procedure was predicated, enumerating among others that the plant would be built in the most economical period, which in the particular case would cover a total of four years; that the exchange would be opened as soon as it was physically ready in order to receive the revenue then available; that it would be uneconomical to postpone the opening of the exchange until all the subscribers could be attached; that the most economical construction would be to build all the plant of sufficient initial capacity to care for the full number of subscribers now attached; and that *the program of placing the plant and connecting the subscribers would necessarily result in a certain percentage of the plant remaining idle for a period of time.*

After calling particular attention to the fact that no consideration had been given to any possible operating deficit during the period, the court quoted from the summary of the valuation engineer showing the items which had been taken into account and for each of which items a definite sum of money had been determined. It is of interest to look at this summary; for, as above stated, the items include the very items which the witnesses Emery and Hamilton have taken into account in arriving at the cost of the elements making up the going concern value of cross-petitioners' property. After considering at length the testimony, the court added:

"The method followed in the foregoing quotations is not subject to the criticism made by the Supreme Court in the *Galveston* case. The above method does not undertake to capitalize past losses. It assumes a reconstructed plant without business, and gives the cost of securing business of the character and magnitude the company now has in Fort Smith."

That the court correctly decided that case is established by the circumstance that on appeal this Court affirmed that decision in *City of Fort Smith, Ark., et al.* v. *Southwestern Bell Telephone Co.*, 270 U. S. 627. With Justice Brandeis, author of the opinion in the *Galveston* case, still sitting, the Supreme Court, without dissent, in a per curiam opinion affirmed the judgment of the trial court in one sentence:

> "Affirmed with costs, upon the authority of *Newton* v. *Consolidated Gas Co.*, 258 U. S. 165, 175, 66 L. Ed. 538, 547, 42 Sup. Ct. Rep. 264; *Galveston Electric Co.* v. *Galveston*, 258 U. S. 388, 395, 66 L. Ed. 678, 682, 42 Sup. Ct. Rep. 351 * * *."

It is highly important to note that in affirming that decision, which upholds in every particular the contention cross-petitioners are making in this case, this Court cited as authority the *Galveston* case, upon which the Commission and complainant rely.

For many years, the courts have uniformly held that this intangible value is just as real as the element of physical value, and that a regulated enterprise is entitled to have this element of value considered in determining the amount upon which it is permitted to earn a reasonable return and in determining the amount to be amortized.

Some commissions have followed this pronouncement of the courts with apparent reluctance. Others have been quick to seize upon any opportunity to deny the allowance of going concern value and have concealed the fact that they did not actually allow it by stating that they have arrived at the present fair value after due consideration of all the elements of value submitted. Since in those cases, in which the operation of rate orders has been attacked by bills in equity, they have been restricted to a determination of whether or not the orders are confiscatory, the courts have upheld many of these orders in which the going concern value was not actually allowed, but not expressly dis-

allowed, as an element entering into the fair value for rate making purposes; but in refusing to set aside orders of that character the courts uniformly have based their action upon the premise that the evidence is too indefinite, theoretical and speculative to form the basis of a judicial decree annulling the order of a commission, or that the record is not clear that the property was not valued as a part of a going concern rather than as separate items or components. The Commission and complainant rely upon cases of the character last mentioned, and in their petition to this Court have cited several such cases. Indeed, the Commission and complainant have resorted to the same tactics here as those to which we have just referred, namely, of implying, contrary to fact, that this element was considered in arriving at the fair value of the properties, notwithstanding the Commission's unequivocal statement in its opinion that the claim was "disallowed" (R. Vol. VIII, p. 3936). *We submit that the time has come when this issue should be met by the regulatory bodies, and met squarely. If the regulatory bodies are determined to refuse the allowance of going concern value, uniformly upheld by the courts for many years, they should be required to do so candidly, so that the right of review in the courts cannot be circumvented. Let us have an end of this ruse of denying such an allowance and then seeking to cover up the denial under the pretense that all elements of value were considered in arriving at the proper rate base and the amount to be amortized.*

The earliest case we have found which applied the principle of going concern value had to do, not with utility rates, but with the valuation of a railroad for taxation purposes. This case, *Cleveland G. C. & St. P. Ry. Co.* v. *Backus*, 154 U. S. 439, 444, was decided in 1893. The State of Indiana imposed an *ad valorem* tax on the railroad in the proportion to the entire value of its line which the

mileage within the state bore to the entire mileage. There was nothing in the record to show any unusual structures outside the state which would render this apportionment unreasonable. The value so ascertained, however, was in excess of the value of the physical properties separately considered, and on that ground the railroad company attacked the levy as excessive. This Court upheld the levy, and in its opinion observed that the true value of a line of railroad is something more than an aggregation of the values of the separate parts of it. It added that this true value is the aggregate of the values of its separate parts plus that arising from a connected operation of the whole.

In another case, *Adams Express Co.* v. *Ohio State Auditor*, 166 U. S. 185, 219, this Court applied the same rule to the properties of an express company, and in the opinion used this language:

> "* * * Now, whenever separate articles of tangible property are joined together, not simply by unity of ownership, but in a unity of use, there is not infrequently developed a property, intangible though it may be, which in value exceeds the aggregate of the value of the separate pieces of tangible property."

The same principle has been applied in condemnation cases. *National Water Works Co.* v. *Kansas City*, 62 Fed. 853, 865, arose under a statute providing that at the expiration of the franchise of the company the city would purchase the property unless the franchise was extended. The franchise was not renewed at the time of expiration, and a controversy arose between the city and the company as to the value of the property. The city took the position that it was required to pay only for the value of the physical properties separately considered. Judge Brewer, then on the Circuit Court of Appeals, later a member of this Court, wrote an opinion upholding the contention of the water company that in valuing the property for the pur-

pose of taking it over, the city must allow something in excess of the cost of reproduction to account for the difference in the value of a system in operation. Other cases holding that when a city condemns property of a public utility it must make a reasonable allowance for going concern value are *Gloucester Water Supply Co.* v. *City of Gloucester*, 60 N. E. 977, 179 Mass. 365; *Kennebec Water Dist.* v. *Waterville*, 54 Atl. 6, 97 Me. 185; *Newburyport Water Co.* v. *Newburyport*, 47 N. E. 533, 168 Mass. 541.

Omaha v. *Omaha Water Co.*, 218 U. S. 180, 202, was a condemnation case involving the price to be paid by the city to acquire the properties of a water company. The court held that the company was not entitled to an allowance on account of the value of an unexpired franchise or the value of good will, but that it *was entitled to an allowance for going concern value*, observing in that connection:

> "* * * But it did not limit the value to the bare bones of the plant, its physical properties, such as its lands, its machinery, its water pipes, or settling reservoirs, nor to what it would take to reproduce each of its physical features. The value, in equity and justice, must include whatever is contributed by the fact of the connection of the items making a complete and operating plant. The difference between a dead plant and a live one is a real value, and is independent of any franchise to go on, or any mere good will as between such plant and its customers. * * * That there is a difference between even the cost of duplication, less depreciation, of the elements making up the water company plant, and the commercial value of the business as a going concern, is evident."

The earliest case we have found which applies this principle in a rate case is *Spring Valley Water Works* v. *City of San Francisco*, 124 Fed. 574, 594, 595, in which the court held that *in a rate case the same rule applies as in a condemnation case*. The court observed that since the water company had an established business as a going con-

cern in supplying water to customers, its plant had a value by reason of these advantages beyond the mere cost of reproducing the plant, and that such added value must be taken into consideration in determining whether authorized rates were reasonable.

In *Des Moines Gas Co.* v. *Des Moines*, 238 U. S. 153, 165, this Court upheld the right to include going concern value in the rate base, but held that "good will" in its ordinary sense had no place in the valuation of a plant for rate making purposes. In discussing going concern value the court said:

> "* * * That there is an element of value in an assembled and established plant, doing business and earning money, over one not thus advanced, is self-evident. This element of value is a property right, and should be considered in determining the value of the property, upon which the owner has a right to make a fair return when the same is privately owned although dedicated to public use."

In their application to this Court the Commission and complainant observe that the costs incurred by cross-petitioners on which the claim for going concern value is based were charged as expenses during the period of business development. We point out that during those four years the earnings of the system were not sufficient to meet the bond interest, and the companies were forced to borrow to meet ordinary cash requirements. No dividends were paid (R. Vol. II, p. 1279). In this connection it will be remembered also that during the period when these costs were incurred cross-petitioners were engaged as a private enterprise and were not subject to public regulation. But for the necessity of paying out these costs in connection with building up their markets to the normal levels afterwards attained, the money thus expended could have been paid out as dividends to the owners. Cross-petitioners' revenues were derived from private contracts, *and their pur-*

chasers paid not a penny more for the gas purchased from cross-petitioners during that period by reason of the charging of these out-of-pocket costs to expenses. That there is no merit in this contention by the Commission and complainant appears from the opinion of this Court in *Lincoln G. & R. L. Co* v. *Lincoln*, 250 U. S. 256, 267:

> "* * * Again, we question the propriety of the master's treatment of 'going value,' which he seems to have estimated at less than otherwise he would have placed it, on the theory that the company's business had been developed at the expense of the public, in the expenditure of past earnings exceeding a fair return upon the capital invested, and this without any finding or any clear evidence to which our attention has been called, that past earnings were excessive."

In numerous cases the courts have held that going concern value is *property*, which cannot be taken except by due process of law and hence must be considered in rate making proceedings. *New York & Richmond Gas Co.* v. *Prendergast*, 10 Fed. (2) 167; *Citizens Gas Co. of Hannibal* v. *Public Service Commission*, 8 Fed. (2) 632; *Mobile Gas Co.* v. *Patterson*, 293 Fed. 208 (modified on other grounds, 271 U. S. 131); *Monroe Gas Light & Fuel Co.* v. *Michigan Public Utilities Commission*, 11 Fed. (2) 319.

In *McCardle* v. *Indianapolis Water Co.*, 272 U. S. 400, 415, this Court said:

> "* * * The Commission's engineer made no appraisal of water rights or going value. The evidence is more than sufficient to sustain 9.5% for going value. And the reported cases showing amounts generally included by commissions and courts to cover intangible elements of value indicate that 10% of the value of the physical elements would be low when the impressive facts reported by the Commission in this case are taken into account."

In a footnote in this case, at page 415, this Court cited a number of cases from various states in which 10% to 16%

was added to the value of the physical properties as going concern value in arriving at the rate base. One of these cases was *Pioneer T. & T. Co.* v. *Westenhaver,* 118 Pac. 354, 360-1, 29 Okla. 429, in which the court very aptly discussed the point here under consideration. Since this Court cited the case with approval, we feel justified in quoting from the opinion at some length:

"But subscribers are not obtained without expenditure of money, labor and time, during which the capital invested in the plant earns nothing, and often fails to pay operating expenses. The customers must be connected with the system of the plant; trained employees must be obtained; and a system of operation must be established. Few industries, if any, involving an investment of $90,000 or more, can be made self-sustaining from the first day of their operation. The uncontradicted evidence in this case discloses that appellant's plant, for the years preceding the first hearing, failed to produce revenue sufficient for operating expenses, current repair, and lay aside an amount for depreciation. During the time of development, there is a loss of money actually expended and of dividends upon the property invested. How shall this be taken care of? Must it be borne by the owner of the plant? Or by the initial customers? Or shall it be treated as part of the investment or value of the plant, constituting the basis upon which charges shall be made to all customers who receive the benefits from the increased service-rendering power of the plant by reason of these expenditures? It seems that the last solution is the logical, just, and correct one. If rates were to be charged from the beginning so as to cover these expenditures and earn a dividend from the time the plant is first operated, the rate to the first customers would be in many instances, if not in all, so exorbitant as to be prohibitive, and would be so at the time when the plant could be of least service to them. On the other hand, the public cannot expect as a business proposition, or demand as a legal right, that this loss shall be borne by him who furnishes the service; for investors in public service property make such invest-

ments for the return they will yield; and, if the law required that a portion of the investments shall never yield any return, but shall be a total loss to the investor, capital would unwillingly be placed into such class of investments; but the law, in our opinion, does not so require. Private property can no more be taken in this method for public use without compensation, than by any other method. When the use of the property and the expenditures made during the non-expense-paying and nondividend-paying period of the plant are treated as an element of the value of the property upon which fair returns shall be allowed, then the burden is distributed among those who receive the benefits of the expenditures and the use of the property in its enhanced value."

Another case cited by this Court in the same foothote was *State* v. *Southwestern Bell Telephone Co.*, 223 Pac. 771, 782-3, 15 Kan. 236, in which the court quoted from the report of the commissioner as follows:

"The telephone company has included in its appraisal an item for going concern value, or cost of establishing the business. The commission has allowed no such item. The commission's position is that taxes and interest during construction include all the elements entering into that charge."

After quoting from *Des Moines Gas Co.* v. *Des Moines*, 238 U. S. 153, the commissioner then continued:

"That this is not compensated for by the mere allowance of taxes and interest during construction is apparent. Interest and taxes during construction are integral parts of building costs, and enter into the cost of the completed structure, whether it has an established business or not. * * *

"I am very doubtful whether an operating loss in the early period of the company's business may be charged as an item of value. * * * I have therefore made no allowance as a part of the going concern value for early operating losses.

"At the same time it seems clear that, no matter

how excellent the management may be, it could not be expected that a newly constructed plant could commence operations on the date that the plant is ready for business with 100 per cent of its business attached and returning revenue. In other words, it is economical to start operations as soon as you can, getting what revenue you can, notwithstanding the fact that the entire business is not established nor the plant entirely completed. * * *

"I have therefore arrived at this conclusion: *That the plant is not a fully completed plant until all the wires are run to connect the entire business, and that the construction period in reality covers a year after the plant has commenced operations.* I have figured that during that year 75 per cent of the plant was in use and earning a return and depreciation, and that taxes, return, reserve for replacements, and certain overhead operating expenses on the other 25 per cent should be capitalized as going concern value." (Italics ours.)

After considering the conclusions of the commissioner and citing several cases supporting these conclusions, the court approved the recommendation of the commissioner in these words:

"No reason is apparent why this court should reach a conclusion concerning the going concern value different from that reached by the commissioner."

We refer now briefly to some of the cases illustrating the type of testimony that has been rejected as the basis of going concern value, and also some of the cases illustrating the difficulty in which the regulated concern finds itself in a court of review where the commission fails to pass squarely on the question of whether going concern value should be allowed.

In *Los Angeles G. & E. Co.* v. *Railroad Commission*, 289 U. S. 287, 313-14, 316, the Chief Justice discussed at some length many of the cases already cited. He observed that the court had held that there is an element of value in an

assembled and established plant, doing business, over one not thus advanced; that this element of value is a property right which should be considered in determining the value of the property on which the owner has a right to a fair return; that going concern value is not to be confused with good will; and that this recognition does not countenance mere attempts to recoup past losses. He then commented upon the difficulty of applying the principle, stating in that connection that it does not give license to mere speculation but calls for a consideration of the *history and circumstances of the particular enterprise.* Once more he called attention to the distinction between legislative and judicial functions, pointing out that it is the appropriate task of the commission to determine the value as that of an integrated operating enterprise, while it is the function of the court in deciding whether rates are confiscatory only to examine the result of the legislative action in order to determine whether the total effect is confiscatory. He quoted from the opinion of the commission, in which it stated that the valuation at which it had arrived was considered to be:

> "* * * The fair value of the property here involved as a going property with business attached, giving full effect to the current level of prices and allowing for any intangible elements of value not fully cared for in the current and usual operating expense."

In view of the statement by the commission that it had made allowance for intangible elements of value, he continued that the court could not say that the final result was an inadequate rate base rendering the rates confiscatory. Obviously, that is no holding that going concern value, where properly proved, could be eliminated from the rate base by the commission. The Commission and complainant cite this case in their application for writ of certiorari; but it is obviously not in point in the light of

the facts presented in this record to which we have already referred.

Another case on which the Commission and complainant rely is *Dayton P. & L. Co.* v. *Public Utilities Commission*, 292 U. S. 290, 308. In that case Justice Cardozo, far from holding that going concern value should not be considered, observed:

> "The decisions of this court show what the going value means, * * * distinguish it from good will, and hold that upon *proof of its existence* it may have a place in the base upon which rates are to be computed." (Italics ours.)

Justice Cardozo then pointed out that the commission took the view that whatever increment of value had emerged from the combining of the parts into one organism and causing them to work together was "sufficiently reflected in the allowance of the cost of developing 'new business' and in the appraisal of the physical assets as parts of an assembled whole." It thus appears that the cost of developing new business had been allowed in that case. It is clear that that is all we asked the Commission to allow in the present case.

Still another case on which the Commission and complainant rely is *Columbus G. & F. Co.* v. *Public Utility Commission*, 292 U. S. 398, 412-13, in which the court, in an opinion written also by Justice Cardozo, held that the record justified the holding by the commission that the going concern value was reflected in the other items and particularly in the appraisal of the physical assets as part of an assembled whole. The court pointed out also that some of the experts testifying on the point included interest or return unearned during the business development period as a factor contributing to going value, and observed that it was the same method of computation as that condemned in the Galveston case, to which we shall have

occasion to refer later. To emphasize the clear distinction between the facts presented by that case and the facts here presented, we quote from the opinion:

> "* * * No evidence was offered by the appellant that expenses had been incurred 'in overcoming initial difficulties incident to operation and in securing patronage.' *Galveston Electric Co.* v. *Galveston, supra.* On the contrary there is evidence as to the business in Columbus that customers were clamoring for an extension of the service, to such an extent that a suit was begun for a mandatory injunction. * * *.
>
> "Other experts, who reject the factor of interest unearned during the period of development, build their estimates of going value upon the cost of attaching new customers to the business, *a cost not taken from the books but merely presumed or estimated at widely variant amounts.* * * *
>
> "Other experts, testifying to an aggregate, without assigning a proportion to the contributory factors, give estimates so vague as to be little more than guesses, one of them, for illustration, holding to the opinion that ten would be a fair percentage, yet unable to give a reason why the amount should not be less or greater.
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> "From the testimony as a whole one gains a definite impression that the opinions are derived for the most part from a professed experience and understanding of business conditions generally, *and very little from any knowledge of the 'history and circumstances of the particular enterprise.'* * * *
>
> "We cannot find that the commission and the court went beyond the bounds of a legitimate discretion in putting aside these estimates as too uncertain to be followed." (Italics ours.)

Thus it appears that in that case some of the testimony was rejected because it was founded on returns unearned, as opposed to cost, and the remainder was rejected because it was based on mere conjecture and not on the history and circumstances of the particular enterprise. In the present case we have an entirely different situation.

It is obvious that the evidence in this case is subject to no such criticism as that expressed by this Court in any of the cases on which the Commission and complainant rely. The practical effect of the decisions is that, because of the difficulty of finding any better evidence thereof, the going concern value in rate proceedings is limited to the cost to the owner of developing that value. Where that cost is shown, as it is shown here, the constitutional administration of the Natural Gas Act requires that cross-petitioners be permitted to earn a reasonable return on such value along with the value of the physical properties, and that such value be returned to them through a proper allowance for amortization.

The Commission erroneously held that cross-petitioners are entitled to amortize only the original cost of their facilities, as contrasted with their present fair value. Even under that erroneous view, the cost of the going concern value, which is just as much a part of that which the operation of the Natural Gas Act subjects to public use as the physical properties, is a part of the original cost. It follows that to the $78,284,009, the original cost of cross-petitioners physical properties, allowed by the Commission as the proper amount to be amortized, must be added $8,500,000, the cost of the going concern value, bringing the total allowance up to $86,784,009.

Even if it be assumed for purposes of argument that cross-petitioners' proof of going concern value in the amount of at least $8,500,000 is inadequate (which assumption is utterly unwarranted), the Commission erred in not allowing *some* going concern value. This record shows beyond fair dispute that cross-petitioners' business has a going concern value over and above the value of the inert physical property. The Commission in its opinion expresses (without warrant) a dissatisfaction with cross-petitioners' evidence that such value is $8,500,000 (R. Vol.

VIII, pp. 3936-7). Because the Commission was dissatisfied with the figures testified to by cross-petitioners' witnesses, the Commission concluded that *no* allowance should be made. The Commission overlooks its duty to fix *fair* rates. Assuming the regulation to be valid, it is in the public interest that fair rates be maintained so that adequate service will be given consumers. In its haste to slash cross-petitioners' profits, the Commission has not performed its duty. If the Commission and complainant were dissatisfied with cross-petitioners' proof as to the amount of going concern value, they should have put on evidence as to the correct amount and the Commission should have ascertained the correct amount. But the Commission and complainant had no time for that. They had to get on with their "interim" order. The authorities discussed above in this section of the brief show beyond dispute that going concern value is property, which cannot be taken without due process.

The Commission and complainant in effect seek to place the burden of proof on cross-petitioners to show their going concern value. This is erroneous. Cross-petitioners did not have the burden of proof on this point, though they did in fact discharge it. They were not and are not plaintiffs in a District Court. The burden of proof is on complainant and the Commission. In *National Labor Relations Board* v. *Abell Co.*, 97 Fed. (2) 951 (C. C. A. 4), the court said with respect to the burden of proof on the charge that the respondent company had fostered a company union (p. 957):

> "* * * In this respect the burden of proof was upon the Union (complainant), and while the charge was supported only by conjecture and suspicion, it was refuted by positive and direct testimony. The failure of the Board to credit this testimony does not supply the lack of affirmative proof of unfair labor practice on the part of the employer."

This case is squarely in point here on the question of going concern value. The court pointed out that not only was the burden of proof on the complainant in that case but that the failure of the Board to credit the company's testimony did not supply the lack of affirmative proof.

On the authority of the cases we have cited, and in the light of the facts showing the actual incurring of every dollar of the costs claimed as making up this item of going concern value, we submit that the order of the Commission, in which that item is not allowed as a part of the rate base and a part of the amount to be amortized, operates to confiscate cross-petitioners' property in the amount claimed and in the amount representing a reasonable return thereon each year. In any event, the Commission's order is confiscatory in that it fails to allow *any* going concern value. Had the Commission not committed the other errors pointed out in this brief, this error alone required that the Commission's order be vacated, and on this ground the holding of the court below on this point should be affirmed.

II.

The Court Below Correctly Held That the Commission's Order Should Be Set Aside Because It Is Confiscatory in That the Commission Provided for the Amortization of Only the Original Cost of the Property and Fixed the Amortization Period at the Entire Life of Cross-Petitioners' Business, Which Commenced Long Prior to Regulation.

A. *The Necessary Operation and Effect of the Natural Gas Act, If Valid, Is to Condemn to Public Use Cross-Petitioners' Property Utilized in the Conduct of Their Business, Which, Prior to the Enactment of the Act, Was a Strictly Private Business.*

B. *A Valid Administration of the Natural Gas Act Requires That Cross-Petitioners Be Compensated by a Proper Amortization Allowance for the Present Fair Value of Their Properties, Including Going Concern Value, as of the Time They Were Condemned for Public Use.*

C. *The Proper Period of Amortization Is That Beginning With Regulation Under the Natural Gas Act and Ending With the Life of Cross-Petitioners' Enterprise.*

(Sec. 3, Summary of Argument, *supra*, p. 56.)

In the proceedings before the Commission cross-petitioners pointed out that the evidence shows conclusively that the reserves on which the life of their enterprise depends would be exhausted prior to the end of 1954. They pointed out also that prior to the enactment of the Natural Gas Act in 1938 they were engaged in a strictly private enterprise, and that only by the operation of that Act was their property subjected to public use. In the light of these facts, cross-petitioners urged that they were entitled to an allowance for amortization which, over the period beginning with the date of the Commission's order, or at the earliest

at the date the Act became effective, and ending with the exhaustion of their reserves of natural gas, would return to them the fair value of their property, including going concern value, as of the time it was first subjected to public use, plus the cost, at present prices, of additional capital facilities necessary to carry on their present business, plus working capital, less salvage value at the end of operations. In Exhibit 211 (R. Vol. VII, p. 3902; Vol. IV, p. 2639) cross-petitioners presented the items making up the amount which they urged they were entitled to receive through amortization, as follows:

Reproduction cost new, excluding gas reserves	$56,302,250
Viewed depreciation (deduct)	2,866,758
Value of gas reserves	13,334,775
Cost of additional property	9,145,083
Going concern value	8,500,000
Working capital	975,000
	$85,390,350
Less salvage	1,049,132
	$84,341,218

The figures making up the total of $84,341,218 are not contradicted. The Commission accepted the reproduction cost new of cross-petitioners' property other than leaseholds in fixing the rate base (R. Vol. VIII, p. 3937). The figures for viewed depreciation are based on the testimony of engineer Biddison, whose testimony is uncontradicted (R. Vol. II, pp. 1284-1310; Exhibit 127, R. Vol. II, p. 1310; Exhibit 142, Vol. III, pp. 1411-12). The Commission accepted the figures submitted as to the present value of the gas reserves (R. Vol. VIII, p. 3937), the figures representing the cost of additional capital facilities (R. Vol. VIII, p. 3938), the figures representing the necessary working capital (R. Vol. VIII, p. 3937), and the figures representing the total liquidating salvage value as of the end of the

period of amortization (R. Vol. VIII, p. 3938). The figures making up the item of going-concern value are undisputed, as pointed out in the next preceding section of this brief.

In its opinion and order the Commission, in arriving at the amount to be amortized, refused to allow the present fair value of the facilities subjected to public use as of the time cross-petitioners' properties were first subjected to public use, and held that only the original cost thereof could be amortized, and refused any allowance for going concern value (R. Vol. VIII, p. 3938). It allowed as a part of the amount to be amortized the cost of additional property and the working capital. By deducting the liquidating salvage value of the properties at the end of the period from the sum of the original cost of the properties first subjected to public use by the enactment of the Natural Gas Act, the cost at present prices of additional capital property, and the working capital, the Commission arrived at the sum of $78,284,009, which it fixed as the amount to be amortized.

The Commission held also that the period of amortization should be 23 years, beginning, not with the date of the order or the date on which the Natural Gas Act became effective, June 21, 1938, but on January 1, 1932, thus distributing the amortization over a period including at least 6½ years during which cross-petitioners operated their business as a private enterprise (R. Vol. VIII, p. 3938).

The questions presented to the court below, therefore, were:

(a) Did the Commission err in holding that cross-petitioners were entitled to amortization of only the original cost of the properties subjected to public use by the enactment of the Act, and in refusing to allow the amortization of the value of such properties as of the time they were first subjected to public use?

(b) Did the Commission err in refusing to fix the period of amortization as beginning with the time cross-petition-

ers' properties were first subjected to public use by the operation of the Natural Gas Act, and in fixing the period as beginning at the time cross-petitioners commenced operations on January 1, 1932?

The questions presented, of course, were not questions of fact or questions of economics, as asserted by the Commission and complainant in their briefs and arguments in the court below. They were strictly legal questions—indeed, questions of constitutional rights. Without regard to whether the Commission stated its position on these several questions by couching it in terms of a finding of fact or of a conclusion of law, the court below and this Court, of course, are in no sense bound by the holding of the Commission on these questions of law.

The court below sustained the contention of cross-petitioners on both of these points, and held that the period of amortization should commence with the date on which the order was issued, or, in any event, at a date not earlier than the date when Congress subjected the industry to regulation, and in effect held that cross-petitioners are entitled to amortization of the value of their property as it existed and was valued at the time the Act was passed (R. Vol. VIII, pp. 4039-41).

The court below held also that cross-petitioners' position on these questions avoids conflicts with the Fifth Amendment to the Constitution—that the position of the Commission and complainant creates an unavoidable clash with that amendment. We submit that the holdings of the court below on these questions were sound and should be sustained.

In approaching the consideration of the questions presented by the propositions here under discussion it will be remembered, of course, that, prior to the enactment of the Natural Gas Act, cross-petitioners were engaged in a strictly private enterprise. The nature of their business

was no different from that of a farmer, equipped with a combine and a truck, who grows his own wheat, harvests it with his own combine, and hauls it to the elevator of his selection in his own truck; or that of the owner of a forest who builds a sawmill and acquires a fleet of trucks and then cuts his timber, saws it into lumber, and trucks it away to purchasers at private sale; or that of the owner of valuable oil lands, who drills wells and builds a pipeline across country to his own refinery, and by that means produces his own oil and transports it to his own refinery to be processed and sold to his selected customers.

Beginning in 1930, cross-petitioners, at a cost of more than $15,800,000 (Exhibit 138, p. 2, line 21, R. Vol. V, p. 3007; Vol. III, p. 1397), acquired title to gas reserves in the Panhandle of Texas and began the development of those reserves. At the same time they commenced the construction of their pipeline. Their purpose was to develop their reserves of natural gas, produce and transport said gas to selected markets in the States of Kansas, Nebraska, Iowa and Illinois. At no time did cross-petitioners hold themselves out to sell gas to the general public. From the beginning their policy and practice has been to sell gas only to a few selected industrial customers along the line and at wholesale to a few selected distributors of natural gas for resale by the latter to the public. 98% of all the gas they have sold has gone to those purchasers at wholesale, only 2% having been sold to the selected industrial customers (Exhibit 9, R. Vol. V, p. 2681, Vol. I, p. 57).

Cross-petitioners invested their money in this enterprise on the theory that they would control their marketing policies; that they would select those to whom they would sell gas, pass upon the credit of such customers, and pass upon the question of whether or not any prospective customer would be able to purchase a sufficient volume of gas to justify the building of a lateral line, in view of the distance

and the physical obstacles, to deliver gas to such particular customer. After prolonged negotiations they fixed the prices at which they sold gas for the various uses made of it by the ultimate consumers by private contracts for a limited term of years. Many of these contracts were for one or two or three years. Others extended for a period of years. Only one extended beyond the year 1946, and that for only an additional five years at the option of cross-petitioners (R. Vol. II, p. 685). Subject to their liability under those private contracts, cross-petitioners were free at any time to go out of the natural gas business should it develop that they could not continue in that business on a satisfactory basis. In other words, they launched this enterprise and invested the large amount of money representing the original cost of their reserves and facilities in a business which they expected and intended to operate in their own interest, just as any private business is operated in the interest of those who establish and own it.

The effect of the Natural Gas Act, if valid, is to change entirely the character of their ownership and the use of their property. They are not given the choice of dedicating their property to the public interest or discontinuing the business of producing, purchasing, transporting and selling natural gas. Upon this ground they have attacked the Natural Gas Act as invalid because in violation of the Fifth Amendment. But for the purposes of the propositions under discussion, let it be assumed that the Act is valid and that cross-petitioners are subject to its provisions. On that assumption cross-petitioners are no longer a private enterprise. Their property is no longer subject to use in the private interests of the owners, but must now be devoted to the public interest. Cross-petitioners are no longer at liberty to withdraw from the natural gas business, however undesirable it may be from their standpoint to continue in that business. They are no longer sole

judges of the credit and the accessibility of any utility within reach of their line. They are no longer at liberty to discontinue the sale and delivery of natural gas to any utility now purchasing gas from them whose business turns out to be unprofitable or for any reason undesirable.

Under the provisions of the Act they must continue in the natural gas business and continue to devote their property to the natural gas business until the Federal Power Commission grants them permission to discontinue their business and to discontinue the use of their property in the public interest. Indeed, they must sell to any utility to which the Federal Power Commission shall direct them to sell; and, whatever the provocation, they are not at liberty, without consent of the Commission, to discontinue selling to any customer to which they are now selling, or to which they may hereafter sell, natural gas. By legislative fiat they have been changed from a strictly private enterprise, owning and operating property for their own private purposes and in their own interests, to the custodians of property which they must operate, whether they like it or not, for the benefit of the public, which has contributed nothing to the development of their property.

This is condemnation. Congress can condemn cross-petitioners' property only by a procedure consistent with due process of law under the Fifth Amendment. As an absolute condition to such a valid condemnation, cross-petitioners must be allowed to earn a reasonable return on the value of their property during the time it shall be subjected to the public interest, and must be allowed to set aside out of earnings over the period an amount which at the end of the period will return to them the value of their property at the time of condemnation.

The operation of the Natural Gas Act is no less a condemnation because cross-petitioners are not divested immediately of the title to their property. It is true they still

have the legal title; but this title is subject to the requirement that this property be continued in the public use until such time as the Commission, designated as the agent of Congress, shall otherwise order. Under condemnation proceedings in the exercise of the right of eminent domain the legal title sometimes passes immediately, as in the case of a site condemned for the erection of a postoffice, a dam, or some other public structure; but often there is no divesting of the legal title, but only the conferring of an easement entitling the holder to the *use* of the property in the public interest. Illustrations of this character of condemnation are right of way easements condemned for the purpose of constructing and operating telephone lines, telegraph lines, electric highlines, railroads, public highways, electric railways and natural gas pipelines. The compensation allowed is only for the particular use of the property for which it was condemned. One who condemns and pays for an easement to build and operate a telephone line is not entitled under such easement to build and operate a railroad along such right of way without again condemning the same right of way and paying additional proper compensation therefor. In the case of condemnation for any of the purposes last enumerated the easement acquired continues only so long as the use continues. The moment that the use is abandoned the owner is immediately reinvested with the fee title. Indeed, he has owned the fee title all along, subject only to the right of the holder of the easement to use it for the purpose for which its use was condemned.

In practical effect, the Natural Gas Act operates to take cross-petitioners' property as well as the use of it; for cross-petitioners must devote this property to the public use so long as the Federal Power Commission directs. This means that as long as natural gas is available, cross-petitioners must continue to produce this gas and transport it through their facilities and sell it in the public interest. When the gas is exhausted cross-petitioners will then find

themselves with the title to property out of which, under the undisputed testimony, they will be able to salvage only about a million dollars. The difference between the present value of the property and ultimate salvage value thereof must be paid to cross-petitioners over the period during which their property is devoted to the public interest.

It was not the money expended by cross-petitioners in 1930 and 1931 in the acquiring of their gas reserves and the construction of their pipelines, compressor stations and other facilities, or that spent for additional capital facilities added from year to year up until the enactment of the Natural Gas Act, which the Act operates to condemn. That money was expended and was beyond the reach of Congress, the Commission or cross-petitioners. It was *the property which cross-petitioners owned and used* in connection with the conduct of their business that Congress required cross-petitioners to subject and devote to the public interest. "It is that property and not the cost of it that is protected by the Fifth Amendment. * * * It is settled by the decisions * * * that just compensation is the value of the property taken at the time of taking." *Brooks-Scanlon Corp.* v. *U. S.*, 265 U. S. 106, 123.

Past earnings or losses, methods of bookkeeping, book entries for depreciation or depletion, failure to make provision in the accounts for amortization, all are immaterial. Original costs of the property and records of past operations and earnings are pertinent here only in so far as they assist in checking present values and in making estimates for the future. It is utterly immaterial what the properties cost cross-petitioners, or how much of that cost has been returned to them in earnings over the period during which they operated as a private enterprise. The property they owned and used in connection with the conduct of their business at the time the Natural Gas Act became effective was their property; and the *value* of that property belonged to them. They cannot be deprived of

that property, or its value, or its use, without the compensation guaranteed to them under the operation of the due process clause of the Fifth Amendment; *nor can they be required to apply as a credit on that value any part of their earnings or revenues prior to the enactment of the Natural Gas Act.* It is just as necessary in fixing the amount to be amortized to provide for the return value *of* the property at the time of condemnation, as in fixing the rate base and the rate of return to provide for a reasonable return *on* that value; *and the compensation for the value of the property, as well as that for its use, must be provided out of earnings subsequent to the condemnation.*

The courts have often pointed out the analogy between condemnation proceedings in the exercise of the right of eminent domain and in the rate making process.

In *San Diego Land & Town Co.* v. *National City,* 74 Fed. 79, 84, the court said:

> "* * * And if, as said by Mr. Justice Brewer in *Ames* v. *Railway Co., supra,* the public were seeking to condemn the property in question for a greater public use, if that be possible, its present value, and not its cost, is that which the public would have to pay. It follows, I think, that where the public undertakes to reduce the rates to be charged for the use of such property, it is its present value, and not its cost, that must be taken as a basis upon which to fix reasonable and just rates."

In *Spring Valley Waterworks* v. *San Francisco,* 124 Fed. 574, 594-5, the court quoted from the case of *Monongahela Navigation Co.* v. *U. S.,* 148 U. S. 312, a condemnation proceeding. Commenting on that case, the court then added:

> "It is true that this was a condemnation proceeding, and the question was to determine what was just compensation for the appropriation of corporate property to a public use, while the case before this court relates to the fixing of water rates which shall be a just compensation for the appropriation of complainant's property to a public use. It is not perceived that there is

any difference in the principles applicable to the two cases, and this appears to have been the view of the Supreme Court in *San Diego Water Co.* v. *San Diego, supra.*"

In *Ames* v. *Union Pac. Ry. Co.*, 64 Fed. 165, 176-7, the court said:

> "• • • Property invested in railroads is as much protected from public appropriation as any other. If taken for public uses, its value must be paid for. Constitutional guaranties, to this extent, are explicit; and in such condemnation proceedings no inquiry is permitted as to how the owners have acquired the property, provided only it be legally held by them. • • • The protection of property implies the protection of its value. • • •
>
> "• • • Now if the public was seeking to take title to the railroad by condemnation, the present value of the property, and not the cost, is that which it would have to pay. In like manner, it may be argued that, when the legislature assumes the right to reduce, the rates so reduced cannot be adjudged unreasonable if, under them, there is earned by the railroad company a fair interest on the actual value of the property."

In *West* v. *Chesapeake, etc., Co.*, 295 U. S. 662, 671, this court said:

> "• • • When the property itself is taken by the exertion of the power of eminent domain, just compensation is its value at the time of the taking. So, where by legislation prescribing rates or charges the use of the property is taken, just compensation assured by these constitutional provisions is a reasonable rate of return upon that value."

The principle for which we are contending operates both ways. If the property condemned and subjected to the public use had cost more than its present fair value, we would expect the Commission and complainant to be here urging that the present fair value of the property, and not its cost, be made the basis of the allowance for amortization. The government has not hesitated to make that con-

tention when the facts are reversed, and it is subject to no criticism in making that contention. In *Vogelstein & Co.* v. *U. S.*, 262 U. S. 337, 340, this Court had under consideration the condemnation of a quantity of copper taken by the government for war purposes. In sustaining the claim of the government that it should pay the value of the copper at the time taken, and not its original cost, which was higher, the court said:

> "* * * The market value of the copper taken at the time it was taken measures the owner's compensation. * * * The higher prices, if any, paid by appellant for the copper it was compelled to take on long-time purchase contracts is not evidence of the value of the copper at the time it was obtained by the United States. The United States is under no obligation to make good the loss. Appellant would be entitled to the gain if it had purchased at less than the market price at the time of taking."

Again, in *U. S.* v. *New River Collieries Co.*, 262 U. S. 341, 344, the government was required, on requisitioning 60,000 tons of coal, to pay the market price therefor, although the government was contending that it should pay only the cost of production plus a reasonable profit.

It is true that the particular question under consideration in the rate cases from which we have quoted was the proper rate base; but there is no difference in the constitutional principle involved between fixing the proper rate base and fixing the proper amount to be amortized. The due process clause of the Fifth Amendment guarantees to cross-petitioners a reasonable return *on* the value of the property as of the time it is subjected to the public use, and, as of the time such public use be terminated, to a return *of* such value less its then salvage value. In the case of a continuing utility of indefinite life, the return *of* the value of the property is secured by an adequate allowance for depreciation, sufficient in amount to replace the facilities as and when they have been worn out or become obsolete.

In the case of an extractive industry like that of cross-petitioners', the life of which is limited by a diminishing source of supply, the return of the value of the property is secured by a proper allowance for amortization which, together with the salvage, will return to them that value as of the time their business terminates. The application of the principle in the fixing of the so-called rate base and in the allowance for depreciation or amortization is clearly and emphatically stated by this Court in *United R. & E. Co.* v. *West*, 280 U. S. 234, 253-4:

> "The allowance for annual depreciation made by the commission was based upon cost. The court of appeals held that this was erroneous and that it should have been based upon present value. The court's view of the matter was plainly right. One of the items of expense to be ascertained and deducted is the amount necessary to restore property worn out or impaired, so as continuously to maintain it as nearly as practicable at the same level of efficiency for the public service. • • • Manifestly this allowance cannot be limited by the original cost, because, if values have advanced, the allowance is not sufficient to maintain the level of efficiency. • • • *It is the settled rule of this court that the rate base is present value, and it would be wholly illogical to adopt a different rule for depreciation.*" (Italics ours.)

In their briefs before the Commission, complainant and the Commission contended that this Court, in *Lindheimer* v. *Illinois Bell Tel. Co.*, 292 U. S. 151, 168, 176, in effect overruled its opinion in the West case, from which we have just quoted, and that the Lindheimer decision requires that the book cost, instead of present value, must be used in determining the amount to be amortized. They have stated that Justice Butler, in his concurring opinion in the Lindheimer case, admitted that that case was a departure from the West case. They may have been misled into making that contention by the assumption of the Supreme Court of Virginia, in *Alexandria Water Co.* v. *City Council of*

Alexandria, 177 S. E. 454, 163 Va. 512, that in the Lindheimer case the court sustained a depreciation allowance computed on the original cost instead of present replacement cost. An examination of the Lindheimer opinion discloses that this Court did not sustain any such allowance. The Commission and complainant have overlooked entirely the questions which were involved in the Lindheimer case. In the opinion, written by the Chief Justice (p. 168), this Court referred to the system of accounting under which depreciation is computed upon the actual cost of the property as entered on the books, less the expected salvage, and is allowed and set up on a straight line annual accrual basis. The Court was not deciding the question of a proper allowance for depreciation in his reference to that system of accounting. Justice Butler's reference (p. 176) was a criticism of the method of accounting employed by the telephone company. After observing that the court's opinion disclosed the principle followed for the ascertainment of the amounts annually charged for depreciation, namely, the straight line method calculated on cost less salvage, which had been prescribed by the Interstate Commerce Commission, he observed in a footnote:

> "This is not in harmony with the principle of our decision in *United R. & E. Co.* v. *West*, • • • which requires replacement cost to be taken as the basis of calculation."

He then pointed out that the rates upon which the company was insisting resulted in deductions which were far in excess of the depreciation being suffered. The company was not upheld in its contentions, and these references to its system of accounting and its setting up depreciation cannot be construed as overruling or modifying the principle announced in the West case. In the Lindheimer case this Court did not approve the charges against the book cost for which the telephone company was contending. Justice Butler was not criticising the opinion of the Chief

Justice, but the practice of the company. It was this practice of the company, and not the opinion of the Chief Justice, which he stated was not in harmony with the West case.

Since the going concern value is as much a part of the value of the property as the physical elements entering into that value, it goes without saying that in fixing the proper amount to be amortized the going concern value must be included. The courts have uniformly held that in condemnation proceedings compensation must be allowed for the going concern value.

In *Brooks-Scanlon Corp.* v. *U. S.*, 265 U. S. 106, 123, a case involving the requisition of a contract to build a ship, the court held:

> "The contract rights of claimant taken are to be distinguished from its expenditures for the production of the ship. The value of property may be greater or less than its cost; and this is true of contract rights and other intangibles as well as of physical things."

In *National Waterworks* v. *Kansas City*, 62 Fed. 853, 865, a condemnation case, the court, in passing upon the amount of the compensation, said:

> "* * * The original cost of the construction cannot control, for 'original cost' and 'present value' are not equivalent terms. Nor would the mere cost of reproducing the waterworks plant be a fair test, because that does not take into account the value which flows from the established connections between the pipes and buildings of the city * * *. A completed system of waterworks, such as the company has, without a single connection between the pipes in the streets and the buildings of the city, would be a property of much less value than that system connected, as it is, with so many buildings, and earning, in consequence thereof, the money which it does earn * * *. The city, by this purchase, steps into possession of a water works plant * * *. It steps into possession of a property which not only has the ability to earn, but is in fact earning.

It should pay therefor not merely the value of a system which might be made to earn, but that of a system which does earn."

We have cited and discussed other cases on this point in presenting the proposition in support of an allowance for going concern value (pp. 84 to 98, *supra.*)

In fixing the amount to be amortized the Commission rejected cross-petitioners' contention and allowed only the original cost of the properties, to the exclusion of any going concern value. In this cost it included the cost of added facilities which will be required in the future and also the amount fixed by cross-petitioners' witnesses as necessary working capital. Cross-petitioners' complaint on this point is that in fixing the compensation for the existing properties the Commission adopted the original cost thereof, and not the present value including going concern value. Under the authorities above cited, this holding of the Commission was clearly erroneous.

We point out that the Commission in its opinion makes no reference to the circumstance that prior to the enactment of the Natural Gas Act cross-petitioners were engaged in a private enterprise and that by the operation of that Act cross-petitioners' properties have been condemned to a public use. That may be accounted for by the circumstance that in the main the opinion follows right along the lines of the brief of its counsel, in which brief no mention was made of that subject. The Commission and complainant did not discuss that subject in their briefs. The reason the Commission, complainant and their counsel ignore this question is manifest. *They cannot answer the position of cross-petitioners on this point.* The best they can do is to assert (R. Vol. VIII, p. 3937), "We believe that the total investment, in contradistinction to claimed fair value, should be amortized and that the amortization period should be the total estimated life of the business, namely, twenty-three years,

rather than the remaining life, fifteen years." Under the authorities to which we have referred, they are clearly in error on both points.

The Commission observes in this connection that the allowances for amortization are recognized and treated as operating expenses and that operating expenses are stated on the basis of cost (R. Vol. VIII, pp. 3937-8). While annual allowances for amortization may be treated as operating expenses by the accountants, as a matter of fact they are not operating expenses in the true sense of the word, but installments on the return of the capital itself. But for the purposes of this argument let us pass that observation. The Commission then says, "There is no more reason to compute amortization expense on the basis of fair value or reproduction cost of the property than there is to substitute fair value or reproduction cost for all other expenses, such as labor, materials, supplies, etc." (R. Vol. VIII, p. 3938). That is an astonishing statement. The allowance for labor, materials and supplies entering into the maintenance and operating expenses is based on present cost of labor, materials and supplies. As applied to those items, present cost and present value are synonymous terms. It is upon these same costs that present value of the capital facilities is reached; for the figures submitted by cross-petitioners as the present value of the capital facilities are the cost of labor and material which enter into the existing capital assets at the present prices, less an offset representing the existing depreciation. Cross-petitioners are not inconsistent. It is the Commission which is inconsistent. Its allowance for maintenance and operation is based on the present cost or present value of the labor, materials and supplies; but in making an allowance for amortization it bases the allowance as to existing facilities on their cost in 1930, 1931, and from year to year as additional capital facilities were acquired.

No authority is cited by the Commission in support of

its holding on the amount to be amortized or the period of amortization. Our searches convince us that no authority can be cited which will support those holdings. The same constitutional principle invoked to support our position that in fixing the amount of amortization at the value of the property as of the time it is first condemned to public use under the Natural Gas Act supports, with equal emphasis, our position that the compensation for the use of that fair value, or return to cross-petitioners *of* that fair value, must be paid at a time *subsequent* to the condemnation. The circumstance that this fair value is not returned to cross-petitioners now does not impair their right to payment of that fair value, less the salvage, during the period over which their property shall be subjected to public use.

During the intervening period, between the time their property is first condemned and the end of the economic life of their project, cross-petitioners are entitled to recover *all* of that difference between the present fair value at the time of condemnation and the salvage value, not 15/23 of that amount, as held by the Commission.

Suppose that cross-petitioners had sold their property shortly before the enactment of the Natural Gas Act for its present fair value. Could it be said that the purchaser, upon having his property condemned for a public use shortly after his purchase, would be required to lose the difference between that present fair value and the amount which the Commission has allowed by going back to the beginning of 1932 and computing the amortization allowance over the entire twenty-three years? Would the purchaser be permitted to come back on cross-petitioners for reimbursement for that difference? These questions answer themselves. Certainly cross-petitioners could be in no different position upon having their property condemned than would be their purchaser.

Suppose that cross-petitioners' line were just now com-

pleted and that its future life would be limited to fifteen years; could the Commission argue that under those conditions they would not be entitled to a return over that fifteen year period of the present fair value of their line, which, of course, under those conditions would be synonymous with the cost of their line? Would the gas produced from the reserves and transported through a new line just now completed be any more valuable than the gas which cross-petitioners are producing and transporting through their line at the present time? What justification could there be for making a distinction between the price of gas transported through a new line and sold at wholesale and the price of the same gas transported through a line, of the same value, which was completed and operated for several years prior to the enactment of the Natural Gas Act? It is the price of the commodity which cross-petitioners produce, transport and sell that the Commission is directed by Congress to regulate.

It is true that during the past years cross-petitioners have made book entries to cover depreciation, depletion and retirements affecting capital assets. The evidence is without contradiction, however, that these charges were made with no reference to amortization and with no reference to the life of the field (R. Vol. IV, pp. 2621, 2646, 2648). No issue is presented here by cross-petitioners as to whether those charges were adequate or otherwise. Cross-petitioners are making no claim for additional allowances on the theory that these charges were too small to cover the actual depreciation. In their figures they have deducted the existing depreciation and they have submitted the figures as to the present fair value of the gas reserves now remaining in their depleted condition. The Commission cannot impose regulation retroactively by going back to the beginning of 1932 and deducting from the proper amount to be amortized, which includes the present value of their properties, an amortization allowance, plus interest thereon,

over eight or nine years prior to the time they were subjected to regulation under the Natural Gas Act. During the first three years cross-petitioners did not earn sufficient revenues to cover what the Commission finds to be a reasonable return plus a proper allowance for amortization. But that is neither here nor there. The past is now history. Whether cross-petitioners made too much or too little prior to regulation is utterly beside the issue. Whether their earnings were paid out as dividends or applied to a retirement of the capital is of absolutely no import; for, as we have stated, the property that was condemned under the Natural Gas Act was cross-petitioners' property. The value of that property belonged to cross-petitioners, and must be returned to cross-petitioners *under* regulation and not *prior* to regulation. Suppose that, instead of subjecting cross-petitioners' property to public use for the purposes of the Natural Gas Act, the government were now condemning cross-petitioners' pipeline and facilities for the purpose of acquiring them and using them to transport crude oil or gasoline in the interest of national defense. Would the government be heard to say that in compensating cross-petitioners for their properties it would be entitled to deduct from their present fair value accruals for depreciation or amortization prior to the time of condemnation? The answer is obvious.

In their brief before the Commission its counsel sought to meet cross-petitioners' proposition on this point by setting up a straw man. They assumed that a company just coming under regulation had only one-fifth or one-tenth of its life remaining, and then insisted that it would be ridiculous to allow the investment to be amortized over the remaining life of the field and thus set the rates at the very high levels that would be required to accomplish such an amortization. The language of this Court in *Willcox* v. *Consolidated Gas Co.*, 212 U. S. 19, 52, is directly in point:

"• • • We do not say there may not possibly be an

exception to it where the property may have increased so enormously in value as to render a rate permitting a reasonable return upon such increased value unjust to the public. How such facts should be treated is not a question now before us, as this case does not present it. We refer to the matter only for the purpose of stating that the decision herein does not prevent an inquiry into the question when, if ever, it should be necessarily presented."

We point out, however, that no different situation from that assumed by counsel would obtain if cross-petitioners were just now completing their pipeline and it suddenly developed that their source of supply would be exhausted within the next four or five years. The evidence reveals an actual instance even more extreme than the one just stated. A line to Rochester, N. Y., was built in 1937, but in 1939 it developed that the field upon which the life of the line depended would probably be exhausted in 1940 (R. Vol. IV, p. 2567). The difficulty with counsel for the Commission and complainant is that they have proceeded all through this case on the assumption that under the Natural Gas Act the Commission is charged with regulating *profits* and not charges. Just and reasonable charges are not based entirely upon considerations of what would constitute a fair return. The public is entitled to be charged only what the commodity is reasonably worth; and the regulated company should not be required to sell it for less than it is worth, even if by good management it sells sufficient volumes to enable it to earn more than a barely nonconfiscatory return.

Thus, in *Covington & Lexington Turnpike Co. v. Sandford*, 164 U. S. 578, 596, this Court said:

"The public cannot properly be subjected to unreasonable rates, in order simply that stockholders may earn dividends."

Again, in *Smyth* v. *Ames*, 169 U. S. 466, 547, the Court said:

> "• • • What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it • • • than the services rendered by it are reasonably worth."

It follows, therefore, that if the charges necessary to yield a fair return and amortize the value of the property are so high as to be excessive *per se*, they will not be fixed at such high levels. That cross-petitioners' prices cannot be thus described is established conclusively by the fact that they were fixed by private negotiation, and that in negotiating the prices cross-petitioners were forced to compete with the prices of the competing fuels which were replaced by natural gas. The fact is that it would be futile for the Commission to fix a price at a level above that which cross-petitioners could obtain in competition with other fuels; for the purchasers would not pay that price.

When and if such a question as that presented by counsel in their straw man illustration shall confront the Commission, the Commission will then be forced to look, as it should have looked in this case, to evidence of what would constitute just and reasonable charges, and not, as it has done here, to evidence dealing solely with cross-petitioners' profits over and above a barely non-confiscatory return.

The regulation of natural gas pipelines is comparatively new and the cases dealing with the period of amortization are few; but the soundness of cross-petitioners' position is manifest.

However, we are not entirely without authority showing how commissions and courts have dealt with this subject in fixing the charges of those engaged in this industry. Two cases involving the United Fuel Gas Company are in

point. In one of these cases the court held that amortization should begin at the time the company, by obtaining franchises *and selling gas to the public generally, first dedicated its property to public use.* In the other case the court held that amortization should be from the time the regulating commission *first set the rates* and made an allowance for amortization.

The United Fuel Gas Company was organized in 1903. Between that date and 1910 it acquired substantial gas reserves and properties. In 1910 it constructed a transportation system and, as a public utility, procured franchises under which it engaged in operating distribution systems in various towns and cities in West Virginia and Kentucky. Its rates in West Virginia were regulated commencing in 1913. In 1925 it applied to the commission in West Virginia for an increase in the existing rates. The increase was denied, whereupon a bill charging confiscation was filed with a Federal Court of three judges. That court held that confiscation had not been established. *United Fuel Gas Co.* v. *Public Service Commission,* 14 Fed. (2) 209, 225.

Regulation of the company's rates in Kentucky commenced in 1920. In 1924 it applied to the Railroad Commission of Kentucky for an increase in rates. The increase was denied and the company again attacked the commission's order in a Federal Court of three judges. That court also held that confiscation had not been established. *United Fuel Gas Co.* v. *Railroad Commission,* 13 Fed. (2) 510, 526.

The company appealed to this Court in both these cases. The two cases were submitted to this Court together and were finally disposed of in opinions written by the present Chief Justice. *United Fuel Gas Co.* v. *Public Service Commission,* 278 U. S. 322; *United Fuel Gas Co.* v. *Railroad Commission,* 278 U. S. 300.

In the West Virginia case the trial court specifically held that a natural gas company should be permitted to amortize the *present value* of its physical properties and its gas reserves, if that value could be proven. It is true that in that case the cost of the gas reserves was used as the best evidence of present value for lack of better evidence of present value; but it must be noted that original cost was *not used in lieu of* present value.

In the Kentucky case the trial court expressed the opinion that the reproduction cost less observed depreciation should be used as the present value of the property other than gas rights; that to this sum should be added $3,000,000 as going concern value; and that, as to gas rights, present value should be used if it could be determined, otherwise book value should be *treated as present value.* In the latter case this Court observed that it was assumed that the present reproduction value, if obtainable, would be taken as the rate base, and that depreciation or amortization would be calculated on the basis of present value of the property rather than on the original cost or investment (278 U. S. 313).

In fixing the allowance for depreciation and amortization in the Kentucky case, the Court found the life of the utility to be thirty-three years, fifteen years, beginning in 1910, having already elapsed. The amortization was distributed over the entire thirty-three years, and not over the eighteen years remaining in the future; *but it will be noted that it fixed the beginning of the period of amortization as of 1910, when the company voluntarily dedicated its properties to the public use* by entering upon the distribution of gas to the general public, under franchises as a public utility, and not as of 1903, when it was organzied, or 1909, when it purchased many of its properties.

In the West Virginia case the Public Service Commission held that the amortization period should start, not

with the time the company first operated as a utility, but with the time its rates first became actually regulated by the commission, in 1916 (*In re United Fuel Gas Co.*, Case No. 1516, P. U. R. 1925B, 705), and in that connection said:

> "But it is the judgment of the Commission that instead of spreading this amortization and the adjusted sales over the life of the property, the retirement or amortization should be restricted to the period from 1916 to the present time."

In the language quoted the Commission, of course, was referring to the deduction from the present value to cover amortization already accomplished under regulation.

In the same opinion the commission stated that two questions presented themselves: (1) Should the amount which had thus been allowed and collected as amortization be deducted from the book cost of the property or from its fair value? and (2) Within what period should this amount be amortized? It answered the first question in these words:

> "It is the present fair value, as held in the decisions of the United States Supreme Court and our own Supreme Court of Appeals in cases hereinbefore cited, upon which the utility is entitled to earn a fair return; this value being regarded as actual money devoted to the use of the public by the utility. Therefore, it is that actual money, represented here by property, which has appreciated in value, which the gas company is entitled to have *returned to it through amortization.* We must be consistent; if we allow the fair value for one purpose, we must allow it for the other." (Italics ours.)

In answering the second question, the commission found that the future life of the field was not less than eighteen years and that 4.15% annually was "an amount sufficient and necessary for the amortization of the unamortized portion of the present fair value of the property." It

also allowed 1.2% on the rate base, or fair value of the property, for depreciation and depletion.

The trial court (14 Fed. (2) 209) criticized the allowance for amortization by the commission and reduced it from 4.15% of the present fair value to 3.65%, but increased the allowance for depreciation and depletion to 1.5%. This reduction in the allowance for amortization was not due to any criticism of the circumstance that it had been distributed over the future life of the field, but to the fact that the commission had not made a deduction for ultimate salvage value and the fact that the company's witnesses had testified that it would probably have more than eighteen years of profitable business life ahead of it.

Thus it appears that in those cases the Kentucky and West Virginia commissions, the trial courts, and this Court, which affirmed the trial court in each case, upheld and applied the contention here made by cross-petitioners to the effect that the fair value of the properties must be amortized and that the period of amortization must begin as of the time the properties are first subjected to public use. The only question that can arise from a consideration of these cases is whether or not the amortization period applicable to cross-petitioners should commence on June 21, 1938, the date the Natural Gas Act was approved, or whether it should commence on August 1, 1940, the date on which the first regulatory order was served on cross-petitioners. Cross-petitioners believe that the rule announced in the Kentucky case is the correct one, for the reason that regulation did not actually overtake cross-petitioners until the order was served; but in no event could the period of amortization commence earlier than the date on which the Natural Gas Act was approved. In either event, the Commission is clearly in error in fixing the amount to be amortized at the original cost of the capital facilities and in fixing the period of amortization

to commence on January 1, 1932, about six and a half years prior to the enactment of the Natural Gas Act, and more than eight and a half years before the first regulatory order.

The life of cross-petitioners' enterprise has a maximum span of fourteen years five months from August 1, 1940, the date of the order, or sixteen years six and a third months from June 21, 1938, the effective date of the Natural Gas Act. In arriving at the annual allowance for amortization, the Commission not only fixed the amortization period at twenty-three years, beginning January 1, 1932, but charged cross-petitioners interest on the annual installments of $1,557,852 from the date last mentioned at 6½%, compounded annually. The error of the Commission in charging 6½% interest, the same as the rate of return allowed, is discused elsewhere in this brief. Let us assume, however, for the purpose of the question under discussion, that it was proper to charge that rate of interest, and then determine the result of the Commission's error in wrongfully fixing the period of amortization to begin on January 1, 1932:

(1) Let us assume that the period should begin as of the date of the order. During the 14 years 5 months between August 1, 1940, and December 31, 1954, $1,557,852 a year would accumulate $22,459,034. Interest on the annual installments at the rate of 6½% per annum, compounded annually, during the period would accumulate an additional $13,018,302, or a total of $35,477,736, principal and interest. Thus it appears that of the $84,341,218, which the court below held cross-petitioners were entitled to amortize, there would be *a deficit over the period of $48,863,482*, which amount would be confiscated solely because of the error of the Commission in using a 23 year period of amortization. If the sum of $78,284,009, erroneously fixed by the Commission as the amount to be amortized, be

used in the calculation, there would be *a deficit over the period of $42,806,263.*

(2) Let us assume that the period should begin as of the date the Natural Gas Act became effective. During the 16 years 6⅓ months between June 21, 1938, and December 31, 1954, $1,557,852 a year would accumulate $25,753,641. Interest on the annual installments at the rate of 6½%, compounded annually during the period, would accumulate an additional $18,193,072, or a total of $43,946,713, principal and interest. Thus it appears that of the $84,341,218, which the court below held cross-petitioners were entitled to amortize, there would be *a deficit over the period of $40,394,505,* which amount would be confiscated solely because of the error of the Commission in using a 23 year period of amortization. If the sum of $78,284,009, erroneously fixed by the Commission as the amount to be amortized, be used in the calculation, there would be *a deficit over the period of $34,337,296.*

We respectfully submit that the court below correctly held that the holdings of the Commission on these questions are in conflict with the due process clause of the Fifth Amendment to the Constitution. It is manifest that the order of the Commission founded upon its erroneous holdings on these questions would inevitably operate to confiscate cross-petitioners' property to the amount of many millions of dollars.

III.

While the Court Below Did Not Pass on the Question, the Commission's Order Should Be Set Aside on the Ground That It Is Confiscatory in That, in Computing the Annual Allowance for Amortization by the Sinking Fund Method, the Commission Charged Cross-Petitioners Compound Interest on the Annual Installments at the Rate of 6½% Per Annum.

A. *In Providing for Amortization the Commission Was Required to Allow Annual Installments for Accruals Out of Earnings Which, Added Together, Will Return the Proper Amount To Be Amortized by the Time Cross-Petitioners' Reserves of Gas Are Exhausted.*

B. *Under the Sinking Fund Method Adopted by the Commission in Computing the Annual Allowance, the Interest Rate Used in the Computation, Under the Uncontradicted Testimony, Must Be No Higher Than 2% Per Annum Compounded Semi-annually.*

(Sec. 4, Summary of Argument, *supra*, p. 58.)

Based on the uncontradicted evidence that the nearest to risk free securities available to them for investment of the annual amortization installments would yield a maximum of 2% per annum, compounded semi-annually, cross-petitioners urged the Commission to use 2%, compounded semi-annually, as the interest rate in the event the Commission adopted the sinking fund method of computing the annual allowance. Disregarding the evidence on this point, the Commission, in computing the allowance by the sinking fund method, used an interest rate of 6½% per annum, compounded annually, on the theory that such rate should be used because it had fixed 6½% per annum as a fair rate of return to cross-petitioners on the rate base allowed.

Cross-petitioners attacked the holding of the Commission on this point on the ground that it was erroneous and would result in confiscation of their property in violation of due process (R. Vol. VIII, pp. 3981, 4029-30).

Having determined that the order should be vacated on other grounds, the court below did not pass on the question; but cross-petitioners again raised the question in their cross-petition for writ of certiorari and assigned error to the court below for failing to sustain cross-petitioners' contention on this point (pp. 7-8, 19). We urge this error by the Commission as an additional reason why the decision of the court below, vacating the Commission's order, should be upheld.

For the purposes of the interim order, the Commission assumed that cross-petitioners' reserves will be exhausted by the end of 1954 (R. Vol. VIII, p. 3938). The context of the Commission's opinion shows that, in so assuming, the Commission purported to accept the testimony of cross-petitioners on this point, as suggested by its counsel and counsel for complainant. We have pointed out that the testimony is not to that effect, but rather to the effect that the economic life of cross-petitioners' reserves will fall short of that date by two or three years (R. Vol. II, p. 695). In extending the period of amortization to the end of 1954, the Commission, therefore, subjects cross-petitioners to the serious risk that a substantial part of the amount to which they are entitled through amortization will be lost entirely. In this connection it is pointed out that the figures offered by cross-petitioners and adopted by the Commission show that there will be *no* amount available for amortization during the full year 1954, and less than the amount allowed by the Commission in the year 1953 (Exhibit 142, p. 2, line 23, R. Vol. V, p. 303, Vol. III, p. 1414). For the purpose of this proposition, however, let it be assumed that cross-petitioners' reserves

will permit them to operate to the end of 1954 with earnings sufficient to justify the distribution of the amortization allowance over the entire life, including 1954.

On that assumption it cannot be disputed that cross-petitioners are entitled to a return of the full amount to be amortized at a date not later than the end of 1954. For several reasons it is impracticable to wait until the end of 1954 to make provision for the return of that amount. In the first place, cross-petitioners' properties are subjected to the use of those to whom cross-petitioners will sell gas throughout the period of regulation, and it would be unfair to those purchasing gas at the end of 1954 to place upon them the whole burden of returning the more than eighty-four million dollars to which cross-petitioners are entitled. All those benefiting from the use of cross-petitioners' properties should contribute to the return of that amount. Also, it manifestly would be impracticable to defer the return of this amount, for the reason that cross-petitioners then would find themselves in a position where they could not recover it. They can recover it only through the charges they shall make for natural gas during the period of regulation. It is the settled law, therefore, that in providing for amortization, as in providing for depreciation and depletion, the burden is distributed over the entire period of regulation and is allowed in annual installments or accruals as a part of the revenues.

The simplest way to distribute this burden and arrive at the amount to be set aside each year is to divide the total amount to be returned by the end of the period by the number of years intervening. This is known as the straight line method of computation. For many years in computing depreciation and amortization this method of computation was used uniformly by regulatory bodies and approved by the courts. This method is based upon the theory that the property of the regulated company is con-

tinually being consumed in service and that the owners should be reimbursed therefor concurrently with the consumption. Under this theory the funds reserved from earnings by the depreciation or amortization charges are immediately made available to the company for use for all corporate purposes. It is important to note that where this method is employed the accruals from year to year will in the aggregate amount to the entire value of the property by the time the property is consumed in service.

In the case of the ordinary continuing utility these funds are accrued as depreciation reserves for the purpose of replacing the property as it is worn out in service, on the theory that the money will ultimately be invested in new property on which the owners will continue to receive a fair return. In the case of an enterprise of limited life, such as that of cross-petitioners, the funds are accrued, not for the purpose of replacing the properties, but for the purpose of providing at the end of the service life, a fund in cash to cover the value of the property subjected to public service.

The sinking fund method is based upon the theory that the regulated company is entitled to a fair return upon all property maintained in condition for proper service, regardless of the fact that a part of its service life has been consumed, and that the owners should receive no reimbursement for property consumption until the property shall have been finally retired. Funds reserved from earnings by the amortization charges are, therefore, segregated and allowed to accumulate at interest pending such ultimate reimbursement. It must be remembered that under this method the sum of the annual accruals over the period of service is less than the total value of the property, the amount of the difference depending, of course, on the interest rate applied to the accruals. The funds can not be used indiscriminately for corporate purposes

but, if the owners are to be compensated to the amount of the full value of their properties, the reserves must be used to produce definite and reasonably assured earnings which, added to the annual accruals, will at the end of the project's life aggregate the full value of the property.

The only justification for employing a sinking fund method of computation is that cross-petitioners will receive an amount each year to apply on the total amount to be returned at the end of the period, and that, because the purchasers are paying annual installments on this obligation in advance, they are entitled to be compensated in the charges for the use of the amounts returned from the time of payment to the end of the period. The question immediately arises as to what compensation the purchasers should be allowed on these installments. The issue is squarely drawn between cross-petitioners and the Commission. Cross-petitioners urged before the Commission, and now urge, that this compensation should be the interest at prevailing rates obtaining on investments as nearly free of risk as can be obtained. Under the evidence this rate should not exceed 2%, compounded semi-annually; but the Commission used 6½% (R. Vol. VIII, p. 3938). It adopted this rate on the theory that if a rate of return of 6½% is fair and equitable for the company, by the same token it would seem to be fair and equitable in computing the amortization to be charged (R. Vol. VIII, p. 3938). In other words, the Commission held that if cross-petitioners are entitled to a return of 6½% on the value of their reserves, pipelines and other facilities, the purchasers are entitled to the same rate as interest on the amortization installments. How could the Commission arrive at any such conclusion? Why did the Commission allow cross-petitioners 6½% instead of 2%, the prevailing interest rate on risk free securities? The very fact that cross-petitioners were allowed 6½% as a rate of return shows that even the

Commission recognizes that they are entitled to some compensation for the risk assumed in placing their money in an investment beset with the hazards of the natural gas pipe-line industry. Do the purchasers assume any such risk? It is inconceivable that there is any risk involved to the purchaser of natural gas in paying over to cross-petitioners each year, through the charges, an annual installment on the obligation of such purchasers to return to cross-petitioners their capital by the end of the period of regulation. If there was ever a situation in which no compensation for risk is in order, this is such a situation.

If cross-petitioners take these installments and deposit them in the bank and allow them to lie idle until the end of 1954, the purchasers are not injured. If cross-petitioners invest this money in some hazardous enterprise in which they earn no interest or in which they lose a part or all of the principal, the purchasers are still not injured. If cross-petitioners are fortunate and invest these installments in some venture which turns out to be profitable, it is cross-petitioners, and not the purchasers, who take the risk, and all the compensation for risk involved in the returns from such investment should belong to cross-petitioners, and not to the purchasers. *The most that the purchasers could be entitled to is the compensation which cross-petitioners can obtain for their money in an investment which is the nearest to risk free that can be obtained, so that at the end of the period there will be available, in the annual installments set aside and the interest allowed on those installments, a sum equal to cross-petitioners' capital.*

The evidence is without dispute that in 1939 the yield on the highest grade of bonds was below 3% per annum (Exhibit 185, Chart 1, R. Vol. VII, p. 3579, Vol. IV, p. 2038; Exhibit 152, p. 1, R. Vol. VI, p. 3141, Vol. III, p. 1622); and that the average yield on all outstanding United States Treasury bonds was just above 2% (Exhibit 185, Chart 3, R. Vol. VII, p. 3603, Vol. IV, p. 2038).

The witness Zwiener, an officer of Harris Trust & Savings Bank of Chicago, which has resources of approximately $285,000,000 (R. Vol. III, p. 1367), testified as to the character of securities that would be available to a fiduciary in handling a trust fund and to the yields that could be expected from investments in such securities (R. Vol. III, p. 1368). He testified in substance that there is no security that is absolutely risk free; that the term "risk free security" means a security on which the investor can be absolutely certain that both principal and interest will be paid at the time it becomes due and payable. He stated that this was the only type of security that a fiduciary would consider in investing a trust fund to be administered under instructions that it must be so handled as that both principal and interest would be available at a definite time (R. Vol. III, pp. 1368-9); that he believed that United States Treasury notes and bonds are considered to be as close to risk free investments as are available in the market (R. Vol. III, p. 1369); that falling in the same classification are the high-grade municipal obligations of states, counties, cities and other municipal subdivisions that have a high credit rating, though the obligations of many of the larger cities could not qualify for such classification (R. Vol. III, p. 1368); that under such instructions as those above stated the investor would be limited almost entirely to United States government or municipal bonds; that under present conditions it is not possible to accumulate any sizable block of high-grade municipal bonds of relatively short maturities at any one time (R. Vol. III, p. 1368); that government bonds or notes are always available in blocks of three or four million dollars a year; and that, without keeping the money idle, the most practical investment for such a fund would be in direct government obligations (R. Vol. III, p. 1368).

He prepared and explained Exhibits 132 and 133, which

were received in evidence (R. Vol. V, pp. 2951, 2953, Vol. III, p. 1377). Exhibit 132 contains the quotations and yields of United States Treasury notes and bonds at the close of the market on August 15, 1939, the date on which the witness' studies were prepared. Exhibit 133 shows what the yield would be on a fund invested on January 1, 1940, in securities maturing as close to the end of 1954 as could be obtained, at the quotations above-mentioned. He likewise took securities that would be available at annual intervals after January 1, 1940, with the same maturities and on the same quotations. Naturally, it was necessary for him to use the same quotations rather than speculate concerning quotations in the future. The best that he could do was to calculate the yields over the period between the time of investment and the end of 1954, using the latest quotations obtainable as the basis of the computation. It turned out that the average gross yield on such investments would be 1.52% per annum, from which he deducted .17% per annum as cost of administration, arriving at a net average yield to the investor of 1.35% per annum.

In preparing and submitting Exhibits 141 and 142 (R. Vol. V, pp. 3025, 3029, Vol. III, pp. 1411, 1414), cross-petitioners used this rate of interest in computing the annual allowance for amortization. However, shortly after August 15, 1939, the date on which the witness Zwiener obtained the quotations used in his exhibits, the European war broke out, with the result that the quotations on government securities and other high-grade bonds declined, with a resulting increase in the yields.

After the introduction by cross-petitioners of Exhibits 141 and 142, they called to the stand the witness Delafield, a man of wide financial experience as a banker, as a seller of securities, as a purchaser of securities, and as the financial executive of Columbia Gas & Electric Company, a very large natural gas and utility system (R. Vol. III, p.

1415). Delafield testified that the return to savings banks in New York on their bond investments was a good index of pure interest, and pointed out that these investments aggregated more than $2,000,000,000 in securities purchased under rigid laws designed to prevent investment in unduly risky securities. He stated that their investment account showed a gross return in 1938 of 2.87%, but that this return was subject to deduction for expense of administration (R. Vol. III, p. 1418). In response to a direct question he testified that under present conditions 2% compounded semi-annually would be a reasonable rate to use in computing an amortization reserve (R. Vol. III, p. 1433).

There is no testimony to the effect that any investment of the type approaching risk free securities is available which would yield a return in excess of 2% compounded semi-annually.

In the light of this testimony, cross-petitioners caused Exhibits 210 and 211 to be prepared as supplements of Exhibits 141 and 142, respectively, and in those supplementary exhibits they recalculated the proper annual allowance for amortization, using, instead of 1.35% compounded annually, an interest rate of 2% compounded semi-annually (R. Vol. VII, pp. 3901, 3902; Vol. IV, pp. 2637-9). Under the record in these proceedings no higher rate can be justified.

Courts and commissions have consistently recognized that the interest rate on the sinking fund should be substantially less than the rate of return allowed, and should approximate the rate of yield on the highest grade securities. The reason for this is obvious. Under the sinking fund method of computing the allowance, the total principal amount to be amortized is not returned to the regulated company, but only a portion thereof is returned, the difference being made up by the interest charges. If the

regulated company is to be certain of receiving the full amount over the period of amortization, it manifestly must so invest the installments as to be sure that by the end of the amortization period the investment can be liquidated in an amount which, including the interest, will equal the total amount to be amortized. It can have no assurance that by the end of the period it will have the full value of the property to be amortized unless it avoid risk, as far as risk can be avoided, in the purchase of securities. To charge the regulated company a higher rate of interest than can be realized from the highest type of securities, and thus force it to put the installments to risk or lose a part of its principal, is confiscation."

In *Cheltenham & Abingdon Sewerage Co.* v. *Public Service Commission*, 186 Atl. 149, 160, 122 Pa. Sup. 252, decided in 1936, the court had under review an order of a commission fixing 4% as the interest rate, and, on that basis, $407 as the annual amortization allowance. We quote from the opinion:

> "When the commission fixed 4% as the rate of interest which is to be compounded annually, it did so without any evidence to support such finding. We find no evidence in the record that would warrant the conclusion that $407.00 could be promptly invested at the end of each year at the rate of 4%. Under the method employed by the commission, the stockholders have a right to demand that the fund should be invested in high grade securities. Bank interest as fixed by the Federal Reserve Board is now considerably less than the amount named, and Federal, State and Municipal bonds are selling at less rate. The difference becomes of great importance when it enters into the computation of compound interest. * * * It will readily be seen that the fixing of a rate which is too high is a matter of serious moment."

It is interesting to note that the testimony offered by the Commission shows that the rediscount rates of New

York and Chicago Federal Reserve Banks have not exceeded 2% since the beginning of 1935, and that in 1938 the rates in Chicago were 1½% and in New York 1% (Exhibit 185, Chart 15, R. Vol. VII, p. 3707, Vol. IV, p. 2038). To the same effect is Exhibit 180, p. 4, offered by complainant (R. Vol. VII, p. 3528, Vol. IV, p. 1984).

We refer briefly to some of the instances where courts and commissions have applied the sinking fund method in providing for amortization of depreciation.

In *Re Southern Counties Gas Co.*, P. U. R. 1921B, 705, the sinking fund allowance for the Ventura division of that utility was on a 6% basis, but the rate of return allowed was 8½%.

In *Re Southern Counties Gas Co.*, P. U. R. 1921E, 374, the sinking fund interest rate was 6%, but the rate of return allowed was 9½%. This hearing dealt with rates in the Long Beach area.

In *Re Los Angeles Gas & Electric Corporation*, P. U. R. 1922A, 283, the annuity was on a 6% basis, but the rate of return was 9%.

In *Re Southern California Gas Company*, P. U. R. 1922A, 277, amortization was fixed on a 6% basis, and a rate of return of 9% allowed.

In *Monahan* v. *Pacific G. & E. Co.*, P. U. R. 1916B, 609, the sinking fund rate was 6%, and the rate of return 9.24%.

In *East Bakersfield Improv. Assoc.* v. *San Joaquin Light & Power Co.*, P. U. R. 1916C, 830, the sinking fund rate was 6%, and the rate of return 8%.

In *Re Golden Gate Ferry Co.*, P. U. R. 1927A, 525, the sinking fund rate was 5%, and the rate of return allowed was 10.9%.

In *Re Wisconsin Telephone Co.*, P. U. R. 1925D, 661, the sinking fund rate was fixed at 5%, and the rate of return at 8%.

In *Re United Fuel Gas Co.*, P. U. R. 1925B, 705, the West Virginia commission allowed a straight line amortization for a period of eighteen years of 4.15%, annually plus 1½% for depreciation. This was the equivalent of 3¼% interest on sinking fund basis. It also allowed an 8% rate of return. The three judge court held (*United Fuel Gas Co.* v. *Public Service Commission*, 14 Fed. (2) 209) that this was more than it required since it only required $3.90 paid at the end of each year for eighteen years to amount to $100.00 when compounded at 4%. It pointed out that savings banks at that time would pay that rate. Therefore, it suggested the use of 3.65% as the annual amortization factor. This was the equivalent of 4¼% interest on sinking fund basis. That decision was rendered in May, 1926. Knapp's Exhibit 185 (R. Vol. VII, p. 3579, Vol. IV, p 2038) shows that in that month Moody's Aaa bonds had a yield of $4.71 (as compared with $2.92 in June, 1939). Moody's forty public utilities had bond yields of $5.08 (as compared with a yield of $3.42 in June, 1939).

In *United Fuel Gas Co.* v. *Railroad Commission*, 278 U. S. 300, this Court affirmed the judgment of the trial court, which had approved an order of the Kentucky commission fixing rates. The order had allowed an 8% return, and in addition thereto straight line allowances of 1½% for depreciation and 4½% for amortization over an assumed future life of eighteen years. This allowance was the equivalent of 2.3% interest on the sinking fund basis for amortization.

In *Central Ky. Natural Gas Co.* v. *Railroad Commission*, 60 Fed. (2) 137 (rev. on other grounds, 290 U. S. 264), a three judge court sustained an order which permitted 4% interest on the sinking fund for amortization, and a 7% rate of return. This order was entered in June, 1932. At that time, as appears from Knapp's Exhibit 185 (R. Vol. VII, p. 3579, Vol. IV, p. 2038), the yield on Moody's Aaa bonds was 5.26% (as compared with 2.92% in June, 1939). Yields

on long time U. S. Treasury bonds were then 3.76% (as compared with 2.13% in June, 1939). Ostrander's Exhibit 190, p. 5 (R. Vol. VII, p. 3529, Vol. IV, p. 1984), shows that in 1932 the average yield on fifteen municipal bonds used as an index was 4.65% (as compared with 2.70% in 1939).

In *Clark's Ferry Bridge Co.* v. *Public Service Commission*, 291 U. S. 227, the sinking fund interest was 4% *simple* interest and the rate of return was 7%. The hearing was in 1932, at which time the yield on highest grade utility bonds was 4.81% (as compared with 2.55% in June, 1939). See Ostrander's Exhibit 180, p. 8 (R. Vol. VII, p. 3533, Vol. IV, p. 1984). The average yield on long time U. S. Treasury bonds in that year was 3.68%. See Knapp's Exhibit 185 (R. Vol. VII, p. 3603, Vol. IV, p. 2038). So the rate was lower than the average of U. S. Treasury bonds and the highest grade utility bonds

Thus it appears that, while in many cases an interest rate of 6% has been used in providing a sinking fund for amortization or depreciation, that rate has been arrived at by considering then existing earnings on securities of the highest quality. Courts have consistently allowed a substantial spread between the rate of interest provided for sinking fund and the rate of return allowed the regulated company. This necessarily results from the fact that the rate of return is one determined as being fair to a concern facing the problems and risks of the company whose rates are under consideration, while the rate of interest on the sinking fund is comparable to the returns of securities of the highest class.

We have by no means cited all the cases where the sinking fund interest rate has been discussed. In some cases a sinking fund interest rate of 5% was used (*San Anselmo* v. *Marin Water & Power Co.*, P. U. R. 1916F, 782; *Re Great Western Power*, P. U. R. 1923C, 545; *Re Sweetwater Water Corp*, P. U. R. 1922B, 336; *Dept. Public Works* v.

Pacific Co Bridge Co., P. U. R. 1928D, 278); in some a 4% rate was used (*Re Portland R. Light & P. Co.*, P. U. R. 1916D, 976; *Re Coos & Curry Tel. Co.*, P. U. R. 1924E, 344; *Leighton Chamber of Commerce* v. *Leighton Water Sup. Co.*, P. U. R. 1930D, 198); in some a 3% rate was used (*Re Pierce County Tel. Co.*, P. U. R. 1919F, 92); and in some a 2% rate was used (*Bogart* v. *Wisconsin Tel. Co.*, P. U. R. 1916C, 1020). In practically all of those cases rates of return ranging from 7% to 8% were allowed.

In all the cases cited, the commissions and courts were dealing with pure utilities, holding franchises and facing few risks as compared with those faced by cross-petitioners. Their rates of return were fixed at rates comparable to those which then obtained with respect to other companies having comparable risks; but the interest rates on sinking funds were at approximately the rates then earned on highest types of investment—those which were practically risk free.

In Exhibit 185, Schedule 1 (R. Vol. VII, pp. 3579-89, Vol. IV, p. 2038), it appears that there is a wider spread at the present time between the yields on Aaa and Baa bonds than in former years. The witness Knapp testified that that circumstance indicated that the investor is demanding greater compensation for the risks he undertakes than he did formerly (R. Vol. IV, p. 2125). The same fact appears from Exhibit 180, p. 8 (R. Vol .VII, p. 3533, Vol. IV, p. 1984). In the light of this attitude, it is clear that there is at this time a greater spread between the cost of money raised through bonds and that raised through equity securities, which carry the principal risk, than obtained a few years ago when the cases we have reviewed were decided. On this basis there should be a wider spread between the rate of return allowed cross-petitioners in this proceeding and the rate of return used in computing the amortization reserve by the sinking fund method. They have a right to the benefit of an interest rate on the nearest

to riskless securities that would be available for the investment of the sinking fund. Certainly they should not be required to go out and speculate in stock of any character with a fund like that. They are entitled to the return of the whole amount representing the present value of their property, and if less than that amount is to be returned by the application of the sinking fund method, an interest rate must be used in the computation which will make it certain that by the end of the project's life that full amount can be made available.

We have already pointed out in Section II of this brief (pp. 102 to 129, *supra*) that the trial court erred in spreading the amortization over a 23 year period; but for the purpose of testing the error now under consideration let it be assumed that 23 years was the proper period, and then let us test the effect of this error:

The setting aside of $1,557,852 annually would accumulate during the 23 year period only $35,830,596. The interest on the annual installments, compounded semi-annually at 2%, would in the 23 years accumulate an additional amount of only $9,157,915, or a total accumulation of principal and interest of only $44,988,511. Thus it appears that of the $84,341,218, which the court below rightfully held is the proper amount which cross-petitioners are entitled to amortize, there would be a deficit over the period of $39,352,707, which would be confiscated solely because of the error of the Commission in fixing the interest rate at 6½% instead of 2% in computing the amortization allowance. If the sum of $78,284,009, erroneously fixed by the Commission as the amount to be amortized, be used in the calculation, there would still be *a deficit of $33,295,498* over the whole period.

We submit, therefore, that, without regard to the other errors assigned, the order of the Commission based on this erroneous use of 6½%, compounded annually, as the interest rate in computing the annual allowance for amortization is confiscatory and should be set aside.

IV.

A. While the Court Below Did Not Expressly Pass on the Question, the Commission's Order Should Be Set Aside on the Ground That There Is No Substantial Evidence to Support the Commission's Finding that Cross-Petitioners' Present Charges Are Unjust and Unreasonable.

B. If by Implication It Overruled Cross-Petitioners' Contention on This Point, the Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because There Is No Substantial Evidence to Support the Commission's Finding That Cross-Petitioners' Present Charges Are Unjust and Unreasonable.

(Sec. 5, Summary of Argument, *supra*, p. 60.)

Cross-petitioners, before the Commission and before the court below, urged that there is no substantial evidence to support the Commission's finding that cross-petitioners' present rates are unjust and unreasonable. They pointed out that the Commission and complainant offered no evidence going to the question of whether or not the present rates are unjust and unreasonable, but based the finding entirely on the circumstance that the earnings of cross-petitioners exceed a 6½% rate of return on the rate base erroneously fixed by the Commission; and they urged that 6½% was a barely nonconfiscatory rate of return, even under the theory of the Commission, and that under the facts of this record the circumstance that cross-petitioners' revenues available for return exceed 6½% per annum on the rate base allowed is no evidence that the present rates are unjust and unreasonable.

In the court below the Commission and complainant contended that cross-petitioners did not raise this point in their application for rehearing and, therefore, were precluded from raising it in the court of review (R. Vol. VIII,

p. 4034). The court below overruled this contention of the Commission and complainant (R. Vol. VIII, p. 4034), pointing out that in their application for rehearing cross-petitioners assigned error on this point as follows:

> "The Commission erred in finding that the rates and charges presently charged by petitioners are unjust, unreasonable, unlawful, and violative of the provisions of the Natural Gas Act" (R. Vol. VIII, p. 3971).

The court below also pointed out other assignments of error in the petition in which cross-petitioners complained of related points, which supplement the assignment above quoted (R. Vol. VIII, p. 4034).

Another assignment of error raising this point squarely was presented in cross-petitioners' application to the Commission for rehearing. The sixth assignment of error read:

> "The Commission erred in not holding that the burden of proof rests upon complainant and counsel for the Commission to establish that applicants' existing rates are unjust and unreasonable, *and that such burden has not been discharged*" (R. Vol. VIII, p. 3970).

The court below did not expressly overrule cross-petitioners' contention on this question (R. Vol. VIII, pp. 4033-4, 4035). We assigned error on this point in our cross petition for writ of certiorari (pp. 11 and 19).

The contracts fixing cross petitioners' charges (Exhibit 11, Vol. V, p. 3685, Vol. I, p. 57), filed with the Commission and by reference made a part of the record, are prima facie evidence that such charges are reasonable. *St. Joseph Gas Co.* v. *Barker*, 243 Fed. 206, 213. The enactment of the Natural Gas Act did not overthrow these contracts or set aside the charges upon which the parties to such contracts agreed. The agreed charges will continue to be valid unless and until the Commission, after the completion of the hearing now pending, shall find such charges to be unjust and unreasonable and shall fix new charges

in lieu thereof. *Kaul* v. *American, etc., Telephone Co.*, 147 Pac. 1130, 1131, 95 Kan. 1. The burden of producing substantial evidence that such charges are unjust and unreasonable lies with complainant and the Commission. *L. & N. R. R. Co.* v. *Commission*, 195 Fed. 541, 558. The Commission cannot discharge that burden by mere fiat in the form of a finding. It and complainant must offer substantial proof which will sustain a finding; otherwise the finding must be set aside on review.

The Kaul case was cited with approval in *Wichita R. R. & El. Co.* v. *Public Utilities Commission*, 260 U. S. 48, 58, in which case this Court, in an opinion by Chief Justice Taft, said :

> "The proceeding we are considering is governed by Section 13. That is the general section of the act comprehensively describing the duty of the Commission, vesting it with power to fix and order substituted new rates for existing rates. *The power is expressly made to depend on the condition that, after full hearing and investigation, the Commission shall find existing rates to be unjust, unreasonable* • • •. We conclude that a valid order of the Commission under the act must contain a finding of fact after hearing and investigation, upon whch the order is founded, and that, for lack of such a finding, the order of this case was void.
>
> "This conclusion accords with the construction put upon similar statutes in other states • • •. Moreover, it accords with general principles of constitutional government." (Italics ours.)

In *L. & N. R. R. Co.* v. *I. C. C.*, 195 Fed. 541, 545-6, the Commerce Court said:

> "• • • It is the duty and the privilege of the carrier in the first instance to fix the rates to be charged, and it is only where after due notice and a full hearing—whether on complaint of a shipper or upon investigation by the Commission of its own motion—*it is made to appear that the rate is unjust and unreasonable* that

> the Commission is empowered to fix another. The hearing which is so provided for is not a perfunctory one. The carrier is entitled to know and to rely on what is adduced at it, either for or against the existing rate, and the Commission is not authorized to disregard it and reach a conclusion not at all justified by it." (Italics ours.)

The decision in this case was reversed by this Court on a different point in *I. C. C.* v. *L. & N. R. R. Co.*, 227 U. S. 88, 92, but the legal principle announced by the Commerce Court was sustained in this language:

> "Under the statute the carrier retains the primary right to make rates, but if, after hearing, *they are shown to be unreasonable*, the Commission may set them aside and require the substitution of just for unjust charges. The Commission's right to act depends upon the existence of this fact, and if there was no evidence to show that the rates were unreasonable there was no jurisdiction to make the order." Italics ours.)

In *C. I. & L. Ry. Co.* v. *International Milling Co.*, 43 Fed. (2) 93, 96 (certiorari denied), the Eighth Circuit Court of Appeals held that a rate once legally established remains the rate *until changed in the manner provided by law*, and that where Congress has provided by statute the way in which changes in rates are to be made, the Commission, though enpowered to enact rules, cannot provide for a change in the rates in any other than the statutory manner.

Congress recognized the principle under discussion by expressly providing in the Natural Gas Act that the Commission must first find that the existing charges are unjust and unreasonable before proceeding to fix a different rate (15 U. S. C. 717d(a)). The Commission recognized the principle in its order instituting an investigation of cross-petitioners by declaring that the purpose of the hearing was to enable the Commission, first, to determine whether

cross-petitioners' charges were unjust and unreasonable, etc., and, second, if it should find that the charges are unjust and unreasonable, to determine just and reasonable charges and to fix the same by order (R. Vol. I, p. 8). Counsel for the Commission and complainant recognized the abstract principle by alleging in the complaint and in their motion for interim order that the existing rates are unjust and unreasonable (R. Vol. I, p. 5). The Commission again recognized the principle in its order by entering a finding that cross-petitioners' charges are unjust and unreasonable (R. Vol. VIII, p. 3945); but both the Commission and complainant have wholly failed to *apply* the principle in the proceedings reflected by the record. It is manifest that they have assumed in effect that upon the filing of a complaint with the Commission and the instituting of an investigation by the Commission, the burden of proof is thereby placed upon cross-petitioners to justify the existing rates. In the development of the evidence complainant and the Commission have devoted themselves entirely to an effort to show what would constitute a fair rate of return. In other words, they have proceeded on the theory that the sole object of this proceeding is to reduce cross-petitioners' revenues to an amount yielding a fair return, which complainant and the Commission interpret to mean a barely nonconfiscatory return, notwithstanding the fundamental principle that before any new rate can be set up they must demonstrate by *substantial evidence* that the existing rates are unjust and unreasonable.

Evidence of a barely nonconfiscatory return is not evidence that a rate or charge which yields a higher return is unjust and unreasonable. There is a well-recognized twilight zone or margin between the level of earnings so low as barely to meet the ban against confiscation and a level of earnings so high as to raise a presumption that the supporting charges are unjust and unreasonable. In *Public Service Co.* v. *Board of Utility Commissioners*,

84 N. J. L. 463, 471 (aff'd 94 Atl. 634, 87 N. J. L. 597), the court said:

> "On the one hand, a just and reasonable rate can never exceed, perhaps can rarely equal, the value of the service to the consumer. On the other hand, it can never be made by compulsion of public authority so low as to amount to confiscation. A just and reasonable rate must ordinarily fall somewhere between these two extremes so as to allow both sides to *profit* by the conduct of the business and the improvement of methods and increase of efficiency.
>
> "Justice to the consumer ordinarily would require a rate somewhat less than the full value of the service to him, and justice to the company would ordinarily require a rate above the point at which it would become confiscatory. To induce the investment and continuance of capital, there must be some hope of gain commensurate with that realizable in other businesses. The mere assurance that the investment will not be confiscated will not suffice."

In *Banton* v. *Belt Line Corp.*, 268 U. S. 413, 422-3, this Court held:

> "A commission or other legislative body, in its discretion, may determine to be reasonable and just a rate that is substantially higher than one merely sufficient to justify a judicial finding in a confiscation case that it is high enough to yield a just and reasonable return on the value of the property used to perform the service covered by the rate. The mere fact that a rate is nonconfiscatory does not indicate that it must be deemed to be just and reasonable. It is well known that rates substantially higher than the line between validity and unconstitutionality properly may be deemed to be just and reasonable, and not excessive or extortionate."

Later we shall demonstrate that under the facts presented by the Commission's own witness the rate of return allowed by the Commission is less than the actual cost of refinancing cross-petitioners' properties, and for that rea-

son the charges based on such a rate of return are confiscatory. If it be assumed, however, for the purposes of the proposition now under discussion, that the rate of return fixed by the Commission is barely sufficient to render it nonconfiscatory, which, it is clear from the Commission's opinion, is all the Commission intended to allow, proof supporting that rate of return would be no evidence that charges which would yield a higher return are unjust and unreasonable.

The Commission found (R. Vol. VIII, p. 3945) that cross-petitioners' annual net revenues exceed the amount reasonably necessary (which is the amount yielded by applying a rate of return of 6½% to the rate base fixed by the Commission) by $2,966,852. We search in vain in the opinion, findings and order of the Commission for any evidence upon which the Commission could have relied in finding that cross-petitioners' charges are unjust and unreasonable. Manifestly, it must have proceeded on the theory that the fact that the earnings of cross-petitioners exceed a 6½% rate of return on the rate base allowed by the amount just stated would justify a finding that cross-petitioners' rates are unjust and unreasonable.

The rate of return is only one of the factors to be considered in fixing a rate. *Public Service Co.* v. *Board of Public Utility Commissioners*, 84 N. L. J. 463, 472 (aff'd 94 Atl. 634, 87 N. J. L. 597); *Cotting* v. *Godard*, 183 U. S. 79, 95-7. In the former case the court quotes from the language of Lord Selbourne in *Canada Southern R. Co.* v. *International Bridge Co.*, P. R. App. Cas. 723:

> "The principle must be, when reasonableness comes in question, not what *profit* it may be reasonable for a company to make, but what it is reasonable to charge to the person who is charged. That is the only thing he is concerned with."

It was pointed out in this connection that Lord Selbourne expressly excepted the case where the results to the com-

pany are so enormously disproportionate to the money laid out as to be some evidence that the charge is unreasonable with reference to the person against whom it is charged. We recognize that principle but call attention to the observation that the returns must be "enormously disproportionate" before they are even *some* evidence that the charge yielding the return may be excessive.

In *Cotting* v. *Godard*, above cited, the court said:

> "Pursuing this thought, we add that the state's regulation of his charges is not to be measured by the aggregate of his profits, determined by the volume of business, *but by the question whether any particular charge to an individual dealing with him is, considering the service rendered, an unreasonable exaction.* In other words, if he has a thousand transactions a day, and his charges in each are but a reasonable compensation for the benefit received by the party dealing with him, such charges do not become unreasonable because by reason of the multitude the aggregate of his profits is large. The question is not how much he makes out of his volume of business, but whether in each particular transaction the charge is an unreasonable exaction for the services rendered. He has a right to do business. He has a right to charge for each separate service that which is reasonable compensation therefor, and the legislature may not deny him such reasonable compensation and may not interfere simply because out of the multitude of his transactions the amount of his profits is large. Such was the rule of the common law, even in respect to those engaged in a quasi-public service, independent of legislative action. In any action to recover for an excessive charge, prior to all legislative action, who ever knew of an inquiry as to the amount of the total profits of the party making the charge? Was not the inquiry always limited to the particular charge, and whether that charge was an unreasonable exaction for the services rendered?
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> • • • • •
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> "The authority of the legislature to interfere by a regulation of rates is not an authority to destroy the

principles of those decisions, but simply to enforce them. Its prescription of rates is prima facie evidence of their reasonableness. In other words, it is a legislative declaration that such charges are reasonable compensation for the services rendered, but it does not follow therefrom that the legislature has power to reduce any reasonable charges because by reason of the volume of business done by the party he is making more profit than others in the same or other business. The question is always, not, What does he make as the aggregate of his profits? but, What is the value of the services which he renders to the one seeking and receiving such services? Of course, it may sometimes be, as suggested in the opinion of Lord Chancellor Selbourne, that the amount of the aggregate profits may be a factor in considering the question of the reasonableness of the charges, but it is only one factor, and is not that which finally determines the question of reasonableness. *Now, the controversy in the circuit court proceeded upon the theory that the aggregate of profits was the pivotal fact. To that the testimony was adduced, upon it the findings of the master were made, and in recognition of that fact the opinion of the court was announced. Obviously, as we think, in all this the lines of inquiry were too narrowly pursued.*" (Italics ours.)

In proceedings before many regulatory bodies the elementary principle announced in the above quotations is too often subordinated to a position that defeats its application or is ignored entirely. The rate of return is an essential factor to be considered in a proceeding in equity to enjoin an order alleged to be confiscatory. Unless the prescribed rate is confiscatory, the courts are without power, in an equity proceeding, to set them aside, if the findings of the commission are supported by substantial evidence. This limitation upon the courts' power presents a constant temptation to those who are interested only in rate reductions, and who give no thought or consideration to the doing of justice to those who have invested their money in regulated

enterprises, to set as their objective the prescribing of a rate barely sufficient to justify a judicial finding that it it is not confiscatory. This practice by regulatory bodies was recognized by this Court in the concurring opinion of Justice Brandeis in *Missouri ex rel. S. W. Bell Tel. Co.* v. *Public Service Commission,* 262 U. S. 276, 296-7, which reads:

> "* * * And the tendency developed to fix as reasonable the rate which is not so low as to be confiscatory. Thus, the rule which assumes that rates of utilities will ordinarily be higher than the minimum required by the Constitution has, by the practice of the commissions, eliminated the margin between a reasonable rate and a merely compensatory rate; and in the process of rate making, effective judicial review is often rendered impossible. The result, inherent in the rule itself, is arbitrary action on the part of the rate-regulating body."

That the Commission, consciously or unconsciously, yielded to the temptation referred to in the above quotations is manifest. Instead of approaching the subject in its logical order, the Commission and complainant in developing the evidence went straight to the question of rate of return. After cross-examining cross-petitioners' witnesses on that subject and after offering their own testimony relating to rate of return, they immediately set in motion procedure looking to the entering of an interim order. The Commission made a finding that 6½% on the rate base fixed is a fair annual return to cross-petitioners; but an examination of the opinion (R. Vol. VIII, pp. 3938-40) shows conclusively that the Commission was interested only in fixing a rate of return that would equal the cost of refinancing cross-petitioners' properties. On that point it erred; for it based its findings upon the conclusion of its own witness that with earnings of 6.2% to 6.5% cross-petitioners could refinance their properties with 40% bonds, 20% preferred stock and 40% common

stock. But the very figures adopted by the Commission from this witness' testimony and set out in the opinion (R. Vol. VIII, p. 3939) show that this conclusion was founded on a mathematical error in calculation, as we shall show in more detail later. If it be assumed, however, for the purposes of the proposition now under discussion, that cross-petitioners can refinance their properties on a basis of 6½% per annum, certainly it cannot be said under those circumstances that charges which will yield only 6½%, the cost of refinancing, are more than barely nonconfiscatory charges. It is perfectly clear that all the Commission intended to permit cross-petitioners to have was a barely nonconfiscatory earning as a maximum. It is significant that nowhere in the Natural Gas Act is there a reference to *earnings, profits, return or rate of return!* It is with *rates* and *charges* for natural gas that the Commission is directed to deal. But the latter has devoted its entire attention to the subjects not mentioned, and no attention at all to the subject committed to its hands.

The Commission did not from the evidence as a whole undertake to fix a just and reasonable charge and then apply, as a test of this charge, the 6½% per annum fixed as a fair rate of return to determine whether the charge allowed would yield such a return; but it started at the other end and applied 6½% to the rate base allowed and found the result to be $4,837,328 a year. It then deducted that amount plus the amount it had erroneously fixed as an annual allowance for amortization from the income of cross-petitioners available for amortization and return and reached the result, $2,966,852, which it termed an amount "available for reduction in net revenues" (R. Vol. VIII, p. 3941). In other words, the objective was clearly *to reduce cross-petitioners' revenues, and to determine the amount of the reduction by cutting the income down to a barely nonconfiscatory return!*

As we have already shown in this brief, the Commission

erred in fixing the amount of the rate base. It erred in fixing the amount to be amortized. It erred in fixing the period over which the amount to be amortized should be accumulated. It erred in allowing for amortization each year only an amount which, with interest compounded annually at 6½%, would accrue the amount to be amortized. Later in this brief we shall demonstrate that the finding of the commission that 6½% is a fair rate of return to cross-petitioners is not supported by substantial evidence, and that, under the uncontradicted evidence, the rate of return should be substantially higher than 6½%. It will also appear conclusively that a correction of these errors will more than offset this difference of $2,966,852 which the Commission found to be "available for reduction in net revenues." But for the purposes of this proposition let us assume that there is a difference, in the amount stated, between cross-petitioners' earnings available for amortization and a barely nonconfiscatory return; and on that assumption let us test the finding of the Commission that cross-petitioners' charges are unjust and unreasonable.

We submit that this record discloses beyond question that the finding of the Commission that cross-petitioners' charges are unjust and unreasonable was based upon the mere fact that it reached the conclusion that cross-petitioners' earnings amount to $2,966,852 in excess of a barely nonconfiscatory return, and upon that circumstance alone. *We challenge the Commission and the complainant in their briefs to point out any other fact or circumstance offered in evidence by complainant or the Commission, or found in the evidence offered by cross-petitioners, which would justify any such finding by the Commission.*

Let us see what complainant and the Commission did in the development of this case. In the first place, the Commission directed that cross-petitioners proceed with their evidence before the Commission and complainant offered any evidence (R. Vol. I, p. 15). Cross-petitioners

vigorously protested any such procedure, urging that they were before the Commission to defend themselves against the charges made by the complainant, and any charges which might be made by the Commission, and that the burden of proof did not rest upon them to develop the evidence. At first cross-petitioners declined to proceed with their testimony (R. Vol. I, pp. 16-23), whereupon the Commission offered one witness, who testified principally on questions bearing on the extent of the reserves of natural gas contained in the Panhandle field, where cross-petitioners' producing properties are located, and certain geological facts bearing upon that issue (R. Vol. I, pp. 35-57). He also produced Exhibits 3 to 11, inclusive, and 14 (R. Vol. V, pp. 2673-87, Vol. I, p. 57), dealing with certain general facts concerning cross-petitioners and their operations and certain operating figures and analyses dealing with the years 1934 to 1938 inclusive. (He also produced Exhibits 1, 2, 12 and 13, which were large maps not printed in the record.) *We point out in this connection that all these analyses excluded the years 1932 and 1933.* Complainant offered an accountant, who produced Exhibit 15 (R. Vol. V, pp. 2689-2755, Vol. I, p. 64), showing the earnings statements per books by calendar years from the commencement of cross-petitioners' operations to December 31, 1938. No other evidence was offered by the Commission and complainant at that time.

After cross-examining the Commission's witness, cross-petitioners proceeded with the development of their direct testimony under circumstances which amounted to duress in fact, if not in law; for repeated intimations were made by the Examiner and by counsel for the Commission that the Commission might not permit cross-petitioners to put on their evidence at all unless they proceeded as directed by the Commission (R. Vol. I, pp. 34, 65, 66).

About a month later complainant recalled the same accountant and offered Exhibit 54 (R. Vol. I, pp. 394-8), a

balance sheet taken from cross-petitioners' books *covering the period from December 31, 1934, through 1938,* and at the same time through the same witness offered certain corrections to Exhibit 15 (R. Vol. I, p. 393). No other evidence was offered by either the Commission or complainant until after cross-petitioners announced on October 6, 1939, that they had concluded their direct testimony. Then the Commission and complainant offered testimony related solely to the subject of rate of return.

As soon as the Commission and complainant had developed their testimony going to the subject of rate of return, from which they erroneously arrived at a rate of 6½% as a fair annual return, the proceedings were stopped so far as they were concerned. They never called another of cross-petitioners' witnesses for cross examination. They never offered a witness to testify affirmatively on the question of whether or not cross-petitioners' charges are unjust and unreasonable, or on any other question. They rested their case upon the theory that all they had to do was to show that cross-petitioners' earnings exceeded 6½% per annum on the rate base fixed for the purposes of this order. We submit that that circumstance is not substantial evidence supporting their finding. For that reason this Court, for the purposes of this proposition, is not bound by the Commission's finding on that question. We are not here talking about confiscation. We are discussing the jurisdiction of the Commission to enter an order drastically reducing cross-petitioners' charges before substantial evidence has been produced which will support a finding that the existing charges are unjust and unreasonable.

As stated in the Cotting case (183 U. S. 79, 97), from which we have quoted above, the Commission could not proceed on the theory that the aggregate of profits was the pivotal point under consideration. Can it be said in the light of the facts reflected by this record that a return to cross-petitioners of $2,966,852 in excess of a barely non-

confiscatory return on a rate base of $74,420,424 is so "enormously disproportionate" as to justify a finding that cross-petitioners' rates are unjust and unreasonable? Standing alone, such an excess is not of sufficient consequence to justify even treating it as a factor in considering whether or not cross-petitioners' charges are unjust and unreasonable. To justify the finding of the Commission on this point it was necessary for the Commission and complainant to produce evidence showing that the charges which produce such excess are in fact unjust and unreasonable; and if they desired to use cross-petitioners' net earnings or profits as a factor going to that issue, it was necessary that they produce substantial evidence showing that such alleged excess above a barely nonconfiscatory return rendered the charges unjust and unreasonable—or that there are no facts justifying such alleged excess. For example, they might have proved, if they could, that cross-petitioners' business has been characterized by poor management or by merely ordinary management; that none of its earnings can be attributed to extraordinary management or skill in designing, constructing and operating its facilities; that they have passed through no period during which they earned less than a barely compensatory return; that in the future they will pass through no period during which they will earn less than a barely compensatory return—or, to state it differently, that cross-petitioners have sustained no losses in the past and will sustain no losses in the future; that cross-petitioners are charging more for natural gas than the prices at which that commodity usually sells at wholesale. The Commission has files showing the charges for natural gas of every company engaged in the business of selling natural gas in interstate commerce. It could have drawn upon those files and produced some figures both interesting and enlightening. In other words, the Commission and complainant were required to produce evidence that would negative the justification of the cur-

rent excess above a barely nonconfiscatory return. They offered no such evidence.

No burden rested upon cross-petitioners to justify that difference. As above stated, they have abundantly justified their earnings and have demonstrated in this record that, on a proper rate base, after proper allowances for amortization, they will not have left as an annual return 6½% (Exhibit 142, R. Vol. V, p. 3029, Vol. III, p. 1414). But if it be assumed that there is such a difference, that difference is more than justified by the facts and circumstances under which cross-petitioners have operated and now operate their business.

Let us examine some of the evidence which conclusively demonstrates that cross-petitioners are entitled to more than a mere nonconfiscatory return from their operations. In the first place, cross-petitioners' pipeline system is the first ever organized and put into operation for the transportation of natural gas over such a long distance (R. Vol. I, p. 498). Those who first conceived the project found on thorough investigation that mechanical and other difficu[illegible] rendered it entirely inexpedient to build a pipeline with the type of thick-walled, lap-welded pipe commonly employed in the short distance pipelines then in operation, and transport gas as pressures of 300 to 400 pounds per square inch, as was the practice in the operation of these short pipelines. After exhaustive research and experimentation, they succeeded in designing and causing to be designed a thin-walled pipe capable of tremendously higher stresses than the old type of pipe through which they could transport gas at pressures of more than 700 pounds per square inch. As a result of this pioneering and investigation, those responsible for cross-petitioners' project were able to transport the largest volumes of gas per unit of steel and to transport gas at the lowest cost, per dollar of investment and per unit of distance traversed, that at that time had ever been accomplished in the pipeline industry.

Cross-petitioners were not satisfied with the annual load factor ordinarily achieved by the industry. By intense and sustained diligence they pursued the policy of promoting the sale of gas by their purchasers at wholesale to industrial plants for processing and for fuel, on an interruptible basis which permitted cross-petitioners to protect their obligations under firm contracts to deliver gas for domestic and commercial uses (R. Vol. II, pp. 683-4). By this means the annual load factor of cross-petitioners' pipeline was eventually built up to a much higher figure than that of any other large pipeline (R. Vol. III, p. 1467). Since 1936 they have maintained a load factor of more than 92% of the total rated capacity of the line, an attainment heretofore unheard of in the industry (R. Vol. II, p. 1046).

The result of the employment of higher pressures and higher stresses in the operation of their line, and of maintaining the higher load factor in the volume of gas handled, has been a substantially increased earning for cross-petitioners above that which they would have earned had they constructed and operated their facilities along the conventional lines at a load factor such as was commonly attained in the industry. One witness testified without contradiction that at least $1,207,067 of cross-petitioners' annual revenue is due to this skill in design and operation and to good management in developing and maintaining the load factor above stated (R. Vol. III, p. 1468). Can it be said that that part of the excess over and above a barely non-confiscatory return which is accounted for by this creative skill and efficient management is unjust and unreasonable? No witness so testified.

But that is not all. Cross-petitioners are engaged in an extractive industry. For their source of supply they rely on reserves of natural gas located 950 miles from their principal market in a great gas field in which thousands of operators are competing for the production (R. Vol. I, pp.

629-30). Eight other large pipelines and a large number of smaller ones are transporting gas from the same field (R. Vol. I, pp. 629-30). Dozens of natural gasoline plants and carbon black plants are producing and processing tremendous and increasing quantities of gas each day (R. Vol. I, pp. 631-46). Thousands of oil wells are now producing great quantities of gas in connection with oil production, substantial portions of which gas are wasted to the air (R. Vol. I, p. 630). A number of additional oil wells are being drilled and operated (R. Vol. I, p. 644). Refineries and other industries in and near the field utilize gas as fuel (R. Vol. I, pp. 631-45).

Cross-petitioners are transporting gas a distance of 950 miles, across thirty-one rivers, including the great Missouri and Mississippi Rivers. Some of these streams are extremely treacherous. Many other risks too numerous to discuss here have confronted and now confront cross-petitioners in the operation of their business. Can it be said with justice that because the return to cross-petitioners in an enterprise of such hazard exceeds that of a barely nonconfiscatory return on the value of their property that such return is unjust and unreasonable?

But that still is not all. Like all pipeline companies, cross-petitioners started their operations with a small market outlet. Four years were required to build their load up to the normal level at which it has since been maintained. The Commission in effect has held that a barely non-confiscatory return each year during the entire life of the project would be $6,395,180. The record shows without contradiction that in the year 1932 cross-petitioners' net earnings from operations before amortization and return amounted to only $3,665,594; that in 1933 they amounted to only $4,106,544; and in 1934 to only $6,193,069. After 1934 the earnings increased; but, the average annual earnings for the first seven years has been only $7,629,298 (Exhibit 138, p. 1, line 36; R. Vol. V, p. 3005.

Vol. III, p. 1397). This is only $1,234,118.88 per year above the barely nonconfiscatory return allowed by the Commission. The evidence offered by cross-petitioners, which the Commission accepted for the purposes of the order, shows that the revenues remaining for amortization and return over the whole period from 1932 to 1954, inclusive, will be an average of only $7,993,442 per year, which is only $1,598,262 per year in excess of the amount allowed by the Commission for amortization and return. This evidence as to the losses sustained by cross-petitioners during the first three years of their operations, when they were earning less than the barely nonconfiscatory return fixed by the Commission, may not be considered by a court of equity in determining whether or not a rate is confiscatory; but in passing upon the question raised in this proposition and now immediately before the Court it is proper to consider these past losses. *Galveston Electric Co.* v. *Galveston*, 258 U. S. 388, 396.

The record shows that cross-petitioners are at the peak of their earning capacity. By reason of increased maintenance and operating costs incident to the aging of the line, the decline in the reservoir pressures in the field from which cross-petitioners produce their gas, and other circumstances, all fully shown by the record without contradiction, cross-petitioners' net earnings before amortization and return will steadily decline from the year 1940 through the year 1954, if cross-petitioners are able to continue in business to that date. The exhibit last referred to shows that during the year 1953 cross-petitioners will earn less than the barely nonconfiscatory return allowed by the Commission, and that in the year 1954 they will earn less than one-third of that amount. All these facts and circumstances negative the contention that cross-petitioners are entitled currently to no more than the barely nonconfiscatory return, and must be weighed in determining whether the Commission's finding that cross-petitioners'

charges are unjust and unreasonable, based entirely upon the fact that cross-petitioners, at the peak of their earning capacity, earn $2,966,852 in excess of what the Commission determined to be a barely nonconfiscatory return, is supported by substantial evidence.

But cross-petitioners offered to go further than that. Three times they offered in evidence the contracts, on file with the Commission, of all pipeline companies taking gas from the Panhandle field (R. Vol. III, p. 1720, Vol. IV, pp. 2507-11, Vol. IV, pp. 2651-3). Twice they offered the schedules and contracts referred to in Paragraph A of Order 53 of the Federal Power Commission dated July 5, 1938, and the information requested in Paragraph D of the same order in so far as those companies were concerned (R. Vol. IV, pp. 2507-11, 2651-3). The evidence was rejected on objection by counsel for the Commission and complainant. Those companies own reserves in the same field from which cross-petitioners produce their natural gas. They produce this gas and transport it over varying distances, none exceeding and most greatly less than the distance over which cross-petitioners transport their natural gas. Some of these lines extend to the east and northeast in the same general direction as cross-petitioners' line and through the same character of country, crossing some of the same streams, though only one of them crosses the Mississippi River. Some of them cross comparatively few streams (R. Vol. IV, pp. 2635-6).

Such evidence was clearly admissible as going to the question of whether or not cross-petitioners' charges are unjust and unreasonable. *Cotting* v. *Godard*, 183 U. S. 79, 97; *L. & N. R. R. Co.* v. *U. S.*, 238 U. S. 1, 15-16; *I. C. C.* v. *U. P. Ry. Co.*, 222 U. S. 541, 549; *Western Papermakers Chemical Co.* v. *U. S.*, 271 U. S., 268, 271; *U. S.* v. *N. P. Ry. Co.*, 288 U. S. 490, 500; *Youngstown Sheet & Tube Co* v. *U. S.*, 295 U. S. 476, 480. We have not assigned as error the refusal of the Commission to receive such evidence,

and are not here attempting to assign error on such refusal; but the circumstance of that offer, we submit, illustrates that the Commission had at hand sources from which it could have developed facts bearing upon the primary issue of whether or not cross-petitioners' charges are unjust and unreasonable, and bearing upon the question also of whether or not the alleged excess of cross-petitioners' current earnings above a barely nonconfiscatory return is of such proportions as to constitute it even a factor in determining whether or not cross-petitioners' charges are unjust and unreasonable.

We submit that in the light of these facts, which stand unrefuted, and which are not offset by any other evidence offered by the Commission and complainant, cross-petitioners' earnings constitute no more than a just and reasonable return on the value of their property. But the Court does not have to go with us that far to sustain this proposition, for *cross-petitioners have no burden of showing that they are earning no more than a just and reasonable return.* The burden is upon the Commission and complainant to show that the charges which yield this excess over and above a barely nonconfiscatory return *are unjust and unreasonable.* They have not discharged that burden. The finding of the Commission on that point is not supported by substantial evidence. A finding not supported by substantial evidence in legal effect is no finding at all. The doctrine announced by Chief Justice Taft in *Wichita R. R. & El. Co.* v. *Public Utilities Commission,* 260 U. S. 48, 58, must be applied. Under that case the power to enter an order reducing cross-petitioners' rates is expressly made to depend on a condition that the Commission shall find existing rates to be unjust and unreasonable. Since it has made no valid finding, and can make no valid finding, to that effect in the face of this record, the order must be set aside as void.

We submit, therefore, that, without regard to the other

errors pointed out in this brief, the order of the Commission should be set aside upon the ground that there is no substantial evidence to support the Commission's finding that cross-petitioners' present rates are unjust and unreasonable.

V.

The Court Below Erred in Not Sustaining Cross-Petitioner's Contention That the Commission's Order Should Be Set Aside Because the Commission Did Not Fix New Rates as Required by the Natural Gas Act.

(Sec. 6, Summary of Argument, *supra*, p. 62.)

Section 5(a) of the Natural Gas Act (15 U. S. C. 717d) provides that whenever, after a hearing, the Commission finds that any rate is unreasonable, the Commission shall *determine the reasonable rate* and *"shall fix the same by order."* Obviously the statute means that the Commission shall determine just and reasonable rates and charges from substantial evidence, which in this case it is the duty of the Commission and complainant to produce and offer. The Commission did not determine the just and reasonable rates for cross-petitioner's various classes of contracts; it ordered merely a reduction in operating revenues (R. Vol. VIII, p. 3945-3946). There is no evidence upon which the Commission could have made a determination of reasonable rates. There is no evidence in this record that could possibly throw any light upon that subject. The Commission has doubtless assumed that its evidence relating to the subject of rate of return is all that is required. As will be shown in a subsequent section of this brief, the Commission manifestly intended to fix a so-called fair rate of return at a rate that would barely yield (but which in fact does not yield) revenues sufficient to cover the cost of refinancing cross-petitioners' properties. Complainant and the Commission offered no affirmative evidence, nor did they develop any evidence by cross-ex-

amination of cross-petitioners' witnesses, concerning the charges fixed by the contracts under which cross-petitioners sell natural gas.

It is true that the Commission, by reference, made cross-petitioners' contracts for the sale of gas at wholesale a part of the record in this cause (Exhibit 11, R. Vol. V, p. 2685, Vol. I, p. 5). But neither complainant nor the Commission produced any testimony or evidence showing that the capacity charge was unjust or unreasonable, or that the charge as a whole which embraced the capacity charge, set out in any particular contract, was unjust or unreasonable. At the time the record was made, 47 different contracts were in effect (R. Vol. II, p. 625). Twenty of these are classified as "firm" contracts obligating cross-petitioners to deliver gas for domestic and commercial uses. Two covered the sale of natural gas at the well. The other 25 are classified as interruptible contracts; and each provides for the delivery of gas only when available for certain industrial processing uses or for use as industrial fuel, the price depending upon the use made of the gas by the ultimate purchaser. There is a wide spread between the price received by cross-petitioners for gas sold under firm obligation for ultimate domestic and commercial uses and the prices received for gas sold for other uses. There is likewise a wide spread between the prices received for gas to be used ultimately by different classes of industry for processing and between the latter and the price received for gas sold for ultimate use by industries as boiler fuel.

In the preceding section of this brief, it has been shown that the Commission has not determined, and from this record cannot determine, what would be just and reasonable as a capacity charge or as a commodity charge for gas sold for domestic and commercial consumption, for the various processing uses or for boiler fuel. The Commission and complainant have been content to direct their

entire attack, not upon cross-petitioners' charges, but upon cross-petitioners' profits, based upon the Commission's conception of a proper rate base, proper provision for amortization and a fair rate of return. It seems never to have occurred to either of them that Congress had directed the Commission to determine the *just and reasonable charges* and that Congress has said nothing indicating the purpose to confer power on the Commission to regulate the *profits* of cross-petitioners and others engaged in the same business. Having reached the conclusion, by their erroneous processes of reasoning, that cross-petitioners' profits exceed a barely non-confiscatory return, counsel for the Commission and complainant were so impatient to slash these profits or net earnings that they did not wait to develop the evidence necessary to determine just and reasonable charges as directed by the statute. They proceeded forthwith to seek a so-called "interim" order; and the Commission actually issued such an order directing a reduction of $3,750,000 per annum in cross-petitioners' revenues. They did not determine reasonable rates and charges in cross-petitioners' various classes of contracts and, indeed, entered the order directing this drastic reduction in operating revenues without producing a scintilla of evidence from which such charges, or any of them, could be determined and fixed.

The Commission in its order directed cross-petitioners to file new schedules of rates and charges reflecting the ordered reduction in revenues, and expressly reserved "the right to reject all or any part of such new schedules and in lieu thereof to prescribe the same by further order" (R. Vol. VIII, p. 3946).

Upon which of their charges must cross-petitioners apply this reduction of $3,750,000 a year? Upon what will the Commission base its rejection or its approval of such schedule of rates? Suppose that cross-petitioners take the

entire amount off the commodity charge, or make any other particular distribution of the reduction among their several charges. What has the Commission before it in this record to enable it to determine whether or not cross-petitioners will have applied the reduction where it should be applied? There is absolutely no evidence in this record upon which the Commission could approve or reject any charge which, in the new schedule of the charges, cross-petitioners might make for gas sold to any particular customer for any particular use. Is the purpose of the Commission, when these new schedules shall have been filed, to reopen the hearing and then hear evidence going to the question of whether these charges are just and reasonable? If so, the present order is premature. An order by the Commission based on evidence not now in the record, rejecting or approving the charges set up in the new schedules and directing that the new charges be made effective as to all bills regularly rendered after September 1, 1940 (the effective date provision of the Commission's order, R. Vol. VIII, p. 3946) would clearly be a retroactive order. Cross-petitioners present charges cannot be disturbed until a valid order be entered revising such charges; and the revision cannot be made retroactive.

Let complainant and the Commission complete this record and perform the duty which has been imposed upon them by the Act of Congress. It will then be time enough for the Commission to consider whether it should enter an order, not directing a reduction of cross-petitioners' profits, but fixing, as the statute requires, just and reasonable charges for gas sold by cross-petitioners for the various uses to which such gas is applied.

Cross-petitioners cannot properly be required in the midst of the regulatory proceedings to put into effect lower rates which have not been approved on evidence before the Commission, but which *may* subsequently be approved.

The regulatory process, as Congress in the Natural Gas Act recognizes, involves rates—not profits. Rates must be fixed—not profits determined.

The result of lowering cross-petitioners' *profits* could be attained by raising some rates and lowering others. If the Commission's order is a blanket authority to do this, perhaps as a matter of mere mathematical calculation it could be done, but such an action would be only temporary or tentative. The Commission's entire order is a mere direction that cross-petitioners submit a schedule of rates concerning which the Commission retains a veto power. When the veto power is exercised, what will be the next step? Will it be the submission by cross-petitioners of another proposal, and then others following that until finally the Commission agrees? Until then neither the Commission nor cross-petitioners will have "fixed the rates," except that each proposal of cross-petitioners will be an attrition of some customer's rates of which that customer may, of course, take advantage from the time of its effective date. Sometime, during this extraordinary method of rate making, the Commission would be impelled for the first time to fix the reasonable rates in substitution for such as might be found unreasonable. Congress did not intend that any such fantastic procedure should be called the determining by the Commission of just and reasonable rates and fixing the same by order.

One test of the procedure ordered by the Commission is its practical operation when applied to the rate making process in general; for if the Federal Power Commission can adopt such a procedure so can any other regulatory body having jurisdiction to determine and fix reasonable rates. What would be the result of applying such procedure to rate making in the railroad industry? If the Interstate Commerce Commission should enter an order requiring a given railroad so to adjust its schedule of rates

as to "reflect a reduction" in its operating revenues of at least $3,750,000 per annum, every practical railroad man familiar with the fixing of rates would declare such an order impossible of performance. To carry out such an order would call for a postulate of prescience possessed by no mortal. The order in this case is just as impossible of performance. It is not only unauthorized by the statute, but is contrary to the express mandate of the statute. It is of such character as that on its face it is unfair, unreasonable and confiscatory.

The court below, in rejecting cross-petitioners' contention that the Commission's order is invalid because the Commission did not fix rates, stated that while the Commission's action was "irregular and unusual," it was in no way "harmful or prejudicial" to cross-petitioners and in fact was "favorable to them" (R. Vol. VIII, p. 4032). The court added:

> "We are convinced and so hold, that petitioners (cross-petitioners here) to successfully attack an order of the Commission, must show they are *aggrieved* by the part of the order assailed. We find no *prejudice* to petitioners (cross-petitioners) in the form which the order took" (R. Vol. VIII, p. 4032).

The court pointed out that cross-petitioners might have a little difficulty in convincing customers as to the fairness of the reduction, but that this difficulty is present whether the regulating commission or the companies make the adjustment. The court below in effect took the view that under the Commission's order, cross-petitioners would receive the same total return regardless of how the Commission subsequently adjusted the rates among cross-petitioners' several customers, and that, therefore, there was no prejudice to cross-petitioners in the method adopted by the Commission.

The court below fell into the error, pointed out by Mr. Justice Brandeis in his concurring opinion in *Missouri, ex*

rel. Southwestern Bell Telephone Co. v. *Public Service Commission*, 262 U. S. 276, 296-298. There, Mr. Justice Brandeis, with whom Mr. Justice Holmes concurred, pointed out that the Commission and courts had carried over the tests for confiscation into the field of determining whether rates are reasonable or unreasonable. This resulted in the tendency to fix as reasonable, the rate which is barely above the line of confiscation. Thus, says Mr. Justice Brandeis,

> "The rule which assumes that rates of utilities will ordinarily be higher than the minimum required by the Constitution has, by the practice of the Commissions, eliminated the margin between a reasonable rate and a merely compensatory rate; * * *."

In the instant case, both the Commission and the court below looked no further than the tests of confiscation. As for the Commission, this is entirely clear from the record the Commission made, from the opinion and order of the Commission, and from its action in ordering a reduction in profits, and in its not fixing rates. The Commission did not seek to establish reasonable rates but to cut cross-petitioners' profits to a point barely above the line of confiscation. The court below, while recognizing that a rate substantially higher than a nonconfiscatory rate may be reasonable (*Banton Belt Line Corporation*, 268 U. S. 413) nevertheless stated:

> "Petitioners (cross-petitioners) say * * * (b) reasonableness of rates is determined 'not by what profit it is reasonable to make, but what it is reasonable to charge for the services rendered.' * * *
>
> "We reject, without extended discussion, the contentions * * * (b). They (these contentions) ignore well-established holdings, backed by reason and experience, to the effect that a fair rate of return on a fairly established rate base, supplies the correct test of reasonableness. (Citing *Los Angeles Gas Corporation* v. *Rd. Com.*, 289 U. S. 287.) The value of the

service to users is neither a reasonable rule nor supported by judicial decisions.

"This seems too elementary to require elaborate or supporting argument. Likewise it must be apparent, on this theory of correct rate-making, that the rate of return not only may, but, in a utility rate case, must be, the largely determinative factor of reasonableness" (R. VIII, pp. 4035-4036).

It will be noted that the court below states that the rate of return *must be* the largely determinative factor of reasonableness on this theory of "correct" *rate-making.* It is clear that the court below applies the tests of confiscation in determining the reasonableness of rates and rejects completely the idea of giving any consideration to the reasonableness of the charge for the service rendered.

The court below in effect adopted the philosophy, as did the Commission, that if, considering costs, prices of competing services, etc., the fair price to the purchaser gives, for example, a 3¢ net profit per cubic foot of gas to the regulated concern, and the concern, by skillful management extends its market or decreases its cost so as to increase its total net profit to more than a fair return, say 6½% for purposes of illustration, on the fair value of the property devoted to the public use, then the regulated concern must cut its rates so that its net profit per cubic foot of gas will allow only the 6½% return on the fair value of the property. Cross-petitioners submit that this philosophy is fundamentally wrong. It is contrary to the general principles of regulating utility concerns. It is contrary to the Natural Gas Act and to the Constitution. Such thinking is exactly that condemned by Mr. Justice Brandeis in the *Southwestern Bell Telephone* case. The true theory of rate regulation generally, and under the Natural Gas Act, is to prevent the regulated concerns from charging more than the service is reasonably worth.

The purpose of the regulation is not to destroy the profit motive. If by skillful management, the regulated concern can increase its profits without charging the customer more than the service is reasonably worth, the concern is entitled to those greater profits. The theory adopted by the court below, and by the Commission, amounts to public ownership of the regulated concern. It places the stockholders of the regulated concern in the position of mere money lenders. They advance the capital to the public for the operations of the enterprise, and are limited to a fixed return or interest rate. The profit motive is entirely lacking.

The Commission, in the case at bar, made a bald effort to cut cross-petitioners' profits to a point barely above the line of confiscation and the court below condoned that effort. The Commission, in the midst of the rate regulatory process, attempted to slash cross-petitioners' profits. The failure of the Commission to fix rates is fatal to the Commission's order. The conclusion of the Court below that cross-petitioners are not aggrieved or prejudiced by the order is fallacious and results only from the erroneous theory of the court below that the Natural Gas Act, and rate regulation in general, involves public ownership. If the Commission in this case had fixed reasonable rates on evidence, those rates might yield a higher return than the revenues remaining after the Commission's slash of profits. It is perfectly clear that cross-petitioners are aggrieved and prejudiced because the Commission has not fixed rates on evidence as required by the Natural Gas Act. Cross-petitioners are aggrieved by the slash in profits which has been ordered by the Commission without any regard to the reasonableness or unreasonableness of cross-petitioners' charges.

VI.

The Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because It Is Confiscatory in That It Denies Cross-Petitioners a Fair Rate of Return.

A. *There Is No Substantial Evidence to Support the Finding of the Commission That 6½% Per Annum on the Rate Base Allowed by the Commission Is a Fair Rate of Return for Cross-Petitioners.*

B. *Under the Evidence Submitted by Cross-Petitioners, Which Is Uncontradicted by Any Substantial Evidence, Cross-Petitioners are Entitled to a Rate of Return on the Rate Base Claimed by Them of Not Less Than 8% Per Annum.*

(Sec. 7, Summary of Argument, *supra*, p. 63.)

Cross-petitioners urged before the Commission (R. Vol. VIII, p. 3987) and the court below (R. Vol. VIII, p. 4017) that the finding of the Commission that 6½% per annum is a fair rate of return on the rate base allowed is not supported by substantial evidence and that, under the uncontradicted evidence, cross-petitioners are entitled to a return on the rate base claimed by them of at least 8% per annum. The court below held that there is substantial evidence to support the Commission's finding (R. Vol. VII, p. 4037). Cross-petitioners assigned error to this holding in their cross petition to this Court (pp. 8 and 19).

The record dealing with the subject of this proposition is voluminous. Substantially one-half of the record is devoted to the testimony of the eight witnesses who testified on subjects related to rate of return alone. The remainder of the 10,457 pages of the reporter's transcript

is permeated with evidence going to elements and factors entering into a proper consideration of that subject. Of the 211 exhibits offered, about 64 were devoted to this subject. It is impossible, therefore, to discuss the testimony in any considerable detail in this brief. It is our purpose here to state summarily, with a minimum of discussion, the facts reflected by the evidence.

We recognize that, subject to the constitutional inhibitions against denial of due process and confiscation of property or of the use of property, and to the limitations imposed by law requiring regulatory tribunals to take into account all the proper elements in arriving at the result, the Commission's finding that 6½% per annum is a "fair annual rate of return upon the rate base allowed," if supported by substantial evidence, is binding on the Court. We do not recognize, however, that the Commission had jurisdiction to set aside the existing rates because they yield a return in excess of 6½% on the rate base allowed, without substantial evidence that the existing rates and charges are unjust and unreasonable; nor do we recognize that under the facts presented by this record a return of 6½% on the proper rate base is a reasonable return, the Commission having clearly proceeded on the theory that a return sufficient to cover the cost of financing cross-petitioners' capital structure is a fair return. We shall show that the return allowed does not cover cost of refinancing cross-petitioners' capital structure; but, if it did, a reasonable return to cross-petitioners must, under the facts, be higher than that barely required to cover cost of refinancing.

A regulated concern is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally made at the same time and in the same

general part of the country on investments and other business undertakings attended by corresponding risks and uncertainties. Just compensation depends on many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard for all relevant facts. *Bluefield W. W. & I. Co.* v. *Commission*, 262 U. S. 679, 692.

What may be a fair return for one may be inadequate for another, depending on circumstances, locality and risk. *United R. & E. Co.* v. *West*, 280 U. S. 234, 249.

The compensation must depend greatly upon circumstances and locality, and, among other things, the amount of risk in the business is a most important factor. The less the risk, the less right the investor has to any unusual returns upon investments. *Willcox* v. *Consolidated Gas Co.*, 212 U. S. 19, 48-49.

Capital charges cover the allowance by way of interest for the use of the capital, the allowance for risk incurred, and enough more to attract capital. The reasonable rate to be prescribed by a commission may allow an *efficiently managed* utility much more than the amounts required to cover use of capital, risk, and the necessity to attract capital. *Missouri ex rel. S. W. Bell Tell. Co.* v. *Commission*, 262 U. S. 276, 291.

On cross-examination the Commission's witness Knapp, in response to a direct question as to the elements he thought important to study and develop in connection with arriving at a proper rate of return for cross-petitioners, read into the record ten elements copied from a study by employees of the Federal Communications Commission, referred to in the record as "Factors Underlying Rate of Return in Public Utility Regulation As Disclosed in Court and Commission Decisions" (R. Vol. IV, p. 2418). These ten elements appear to be in complete harmony

with the authorities. We, therefore, quote them verbatim as the basis of cross-petitioners' position here:

"1. A proper return or rate of return is a flexible concept, and not a static rule.

"2. What return is proper necessitates the exercise of an enlightened judgment in each case.

"3. Current conditions are controlling and general conditions affecting all business should be considered.

"4. The return should be sufficient to assure confidence in the financial soundness of the utility to maintain its credit and to attract the required capital.

"5. The propriety of the allowed return depends largely upon the circumstances, locality and risk of the utility enterprise.

"6. The return should be equal to that generally being made at the same time and in the general region on investment in other enterprises which have corresponding risks.

"7. The historical cost of money to the utility and the current cost of money should be considered.

"8. A utility's capital structure, financial history and past operations should be considered.

"9. The return should accomplish, among other things, due recognition of efficiency, or lack of efficiency, in management.

"10. The future prospects of the utility, its taxes, its development, the potential stimulation from reduced rates, and the character of the service should be considered."

Later we shall point out specifically that the range of cross-petitioners' testimony covers all these elements. On the other hand, we shall point out that the testimony of the Commission and complainant took no such range. Their testimony was confined entirely to the current cost of money, principally capital raised through high grade bonds in the electric utility field and through short term financing, and to current business and financial conditions of a very general character. Perhaps we should add that they apparently gave effect to Point 2 with emphasis on the

"exercise of an enlightened judgment in each case." Indeed, the result in view of the record would indicate that they gave effect to little, if anything, else than the exercise of their own "enlightened judgment." There is nothing in its opinion to indicate that the Commission took into account the risks inherent in the natural gas industry, those specifically applicable to cross-petitioners' business, or the returns necessary to attract overall capital to the natural gas pipeline business; or that it gave any recognition to the engineering and creative skill in designing and constructing the facilities and the highly efficient management which has characterized the conduct of cross-petitioners' business. An order predicated upon the allowance of a rate of return barely sufficient to cover cost of financing (in this case it does not cover such cost) does not permit the earning of a reasonable return, and in a review proceeding of this character should be held invalid and set aside, even if it did not operate to confiscate cross-petitioners' property and revenues. But it is not necessary for the Court ever to reach that question in this case: for the order is patently confiscatory.

Cross-petitioners' business is the most beset with uncertainties, risks and hazards of any regulated business. This has been recognized by the courts and by regulatory commissions since the natural gas business was first put under regulation.

Thus, in *Landon* v. *Public Utilities Commission*, 242 Fed. 658, 671 (rev. on other grounds, 249 U. S. 236), the court pointed out that no one can foretell whether gas fields will be fairly permanent or come to a sudden end, and that even the best informed men are liable to be sadly mistaken as to future supply.

Again, in *Wichita Gas Co.* v. *Public Service Commission*, 3 Fed. Supp. 722, 727 (modified on other grounds, 290 U. S. 561), the court observed that competition injects a

hazard into the natural gas business which is not present in mortgages or bonds, and pointed out in that connection that electricity has almost entirely supplanted gas for lighting and is making serious inroads on gas for cooking, and that in the field of heating gas must meet the competition of coal and fuel oil.

In *Cary* v. *Corporation Commission*, 17 Fed. Supp. 772, 776, the court observed that no utility is more hazardous than that of furnishing natural gas, because its success depends not only upon finding and keeping a market for its gas in the face of vigorous competition by electricity, coal and fuel oil, but it depends also upon the life of the gas field from which it draws its supply.

So much of the court's language in *Wichita Gas Co.* v. *Public Service Commission*, 2 Fed. Supp. 792, 810-11 (modified on other grounds, 290 U. S. 561), is pertinent here that we quote from the opinion:

> "The pipeline company is subject to the hazards attendant upon the production of gas, and its transportation to distant markets. The amount of gas it may take from its own wells, and the price it may charge for its product, is subject to regulation by public authority. It must find a market in a highly competitive field. It competes with coal and fuel oil in household heating and for industrial purposes; the competition of fuel oil is particularly formidable for household heating. • • • Electricity has absorbed the household lighting and is making serious inroads on cooking. In short, it must search for and find its gas; transport it hundreds of miles without an hour's interruption; then find and satisfy its customers. The law contemplates that it make no more than a fair return in good times; it should not be forced to take less when times are hard. There is evidence that in years past the profits of the company exceeded 10%. We do not analyze those figures; in rate making, the past must bury its dead; a confiscatory rate cannot be ordered for the future because an exorbitant profit was made in the past. • • •

"* * * In these times, when stock of the best utilities can be purchased on a 9% basis or better, certainly an 8% return on this hazardous enterprise is not unreasonable."

Another case in which it was recognized that the natural gas business is generally more hazardous than the business of an ordinary public utility is *Oklahoma Natural Gas Co.* v. *Corporation Commission*, 216 Pac. 917, 923-4, in which the court said:

"* * * It should be borne in mind that a natural gas public service business is generally more hazardous than the business of any other public utility. The duration of the business is limited by nature, because the commodity in which the utility deals is supplied by nature alone. The supply is limited and is exhaustible, and when exhausted can never be recreated. * * * Artificial gas companies, electric light companies, telephone and telegraph companies, railroad and street railway companies create the basic element of their service; their business is stable and its duration is not limited. The only other public utility which deals in a commodity created by nature only is a water company, and its supply is constantly replenished by nature itself in the falling of rains and the melting of snows. An investment in any of these enterprises is not limited in its duration, but is permanent, and by competent and efficient management an investment therein will yield a permanent return and the company will earn in addition a sum sufficient to take care of depreciation caused by ordinary wear and tear upon the property and replace worn out equipment, so that the investment is at all times stable. But this is not true of a natural gas utility. When the supply of gas is exhausted, the equipment is worthless except for the price it will bring as junk."

Not only the courts but many of the commissions have recognized these extraordinary risks and have made allowances accordingly in fixing the rate of return. *In re Baker Natural Gas Utility*, P. U. R. 1921E, 609 (Montana);

Re West Virginia Central Gas Co., P. U. R. 1918C, 453 (W. Va.); *Municipal Gas Co.* v. *City of Sherman*, P. U. R. 1925E, 67 (Texas); *Re Southern California Gas Co.*, P. U. R. 1922A, 277 (Calif.). In the case last mentioned the commission, after finding the average cost to this company of money to date to be 7%, said:

> "In view of the present high cost of borrowed money it appears just and reasonable to permit a return of 9% in this particular case, especially when consideration is given to the greater hazard attaching to the service of natural gas and to the fact that applicant has made special efforts to reduce the cost of gas service to its consumers by the effecting of substantial economies."

The above cases had to do with companies distributing natural gas, which of all those engaged in the natural gas business are confronted with the least risk and hazard; for, as testified by the witness Gilman, when their source of supply shall be exhausted their facilities can be utilized in distributing artificial gas (R. Vol. III, pp. 1497-8). The changeover will involve some expense; but the capital assets are not lost. The same witness pointed out that a distributing company, upon acquiring production and transportation facilities, becomes more risky in that upon the exhaustion of the supply all the facilities except those devoted to distribution will have to be salvaged (R. Vol. III, p. 1498). Then he pointed out that as between two companies, one owning distribution, production and transportation facilities and the other owning no distribution but only production and transportation facilities, the latter is more risky for the reason that upon the exhaustion of the source of supply all of its capital assets will have to be salvaged (R. Vol. III, pp. 1498-9). Next he pointed out that as between two companies owning only production and transportation facilities, one producing from a number of different fields and the other, like cross-petitioners, producing from only one field, however large, the latter

involves the greater risk and hazard in that upon the exhaustion of that field it will not have other sources of supply to enable it to continue in business (R. Vol. III, p. 1499). Thus it develops that, of all classes of those engaged in this hazardous business, cross-petitioners belong to that class faced with the most risk and hazard.

Cross-petitioners in their testimony pointed out many of the risks confronting the natural gas industry as a whole and cross-petitioners in particular. It is impossible to discuss these risks at length here. In the statement of facts in this brief (p. 13, *et seq., supra*) we have already pointed out and discussed briefly some of the risks and dangers confronting cross-petitioners, namely: (1) danger of failure in the supply of gas (p. 37); (2) danger of increased costs (p. 37); (3) dangers incident to employment of high pressures and high stresses (p. 38); (4) danger of pipeline failures (p. 39); (5) danger that another source of supply nearer to cross-petitioners' market may be discovered (p. 39); (6) danger of competition with other fuels (p. 40); (7) danger of increased taxes and of punitive legislation (p. 41); (8) danger of increasing costs of regulation (p. 43); (9) danger of inflation (p. 44); and (10) danger of varying demand (p. 45).

Another element developed by cross-petitioners' evidence and considered by their witnesses on their rate of return was the creative skill in designing, the engineering skill in constructing and operating, and the superior skill in managing cross-petitioners' pipeline system. In this brief we have already pointed out in some detail the investigations conducted under the direction of those who conceived cross-petitioners' pipeline project (pp. 13-15), the difficulties encountered (pp. 13-15), the creative researches directed to meeting these difficulties (pp. 14-15), the solving of the difficulties and the resulting increased efficiency and improved economic outlook (pp. 13-15), the

extraordinarily high pressures and stresses at which cross-petitioners' facilities are operated (pp. 24-25), and the extraordinarily high load factor achieved and maintained through careful management (p. 25). Some of the very factors that enable cross-petitioners to undertake the venture—such as the thinner wall pipe and the increased operating pressures, with the resulting increased stresses were and are themselves factor of risk. In this connection we pointed out that a very substantial portion of the revenues of cross-petitioners ($1,207,067 of a total of $14,853,600) is realized from the sale of the additional volumes of gas which cross-petitioners have produced, transported and sold as a result of these efficiencies (p. 25). If there was ever a case in which the observation of this Court in *Missouri, ex rel. S. W. Bell Tel. Co.* v. *Commission*, 262 U. S. 276, 291, to the effect that the reasonable rate to be prescribed *may allow an efficiently managed concern much more than the amounts required to cover use of capital, risk and the necessity to attract capital,* would apply, this is that case.

There is no dispute about current financial conditions. The Court will take judicial knowledge of the fact that interest rates on government bonds, high grade municipal and corporate bonds, prime short term commercial loans, and Federal Reserve discount transactions are extremely low. Cross-petitioners' witnesses took note of these circumstances and considered them as far as they throw any light on the question of what would constitute a reasonable rate of return on money invested in a project like that of cross-petitioners' (R. Vol. III, pp. 1415-45, 1451-1635).

The Witnesses for Cross-Petitioners on Rate of Return.

Cross-petitioners called four experts, namely, Emery, Delafield, Gilman and Dorau. These men were drawn from different fields of activity to the end that the subject be presented from every possible viewpoint.

The Testimony of Delafield.

The first witness, Delafield, for seventeen years was employed by the National City Bank and the National City Company of New York in the respective capacities of statistician, securities salesman and managing director of the latter company's business in New England; and a buyer of securities in New York. In 1931 he became financial vice president of Columbia Gas & Electric Corporation and associated companies, which position he still holds. In connection with his duties he has carried on extensive studies into the subject of rate of return and has made frequent appearances before regulatory bodies and courts to testify on that subject (R. Vol. III, p. 1416). He has personally negotiated the sale of all securities sold by his companies and has been in charge of the setting up of those securities (R. Vol. III, p. 1415). He named and analyzed most of the risks inherent in the natural gas pipeline business and stated the reaction of the investing public to these risks (R. Vol. III, pp. 1426, 1430-1, 1439). He prepared and explained Exhibit 147 (R. Vol. VI, pp. 3071-77, Vol. III, p. 1445), a list of 128 companies, each of which has some type of security listed on the Chicago stock exchange. These included all companies with securities listed on the exchange except regulated companies, finance companies, and companies in bankruptcy or receivership, without regard to whether or not the companies operated at a profit or otherwise (R. Vol. III, pp. 1421-4). He explained that his purpose in submitting this exhibit was not to compare the

risks involved in any one of the undertakings listed with the risks of cross-petitioners; that his purpose was simply to show what rates of return were made by business in general, and by successful business, in the general area where cross-petitioners operate; and that he had taken the information therein shown into consideration only "for purposes of orientation" and to demonstrate to his own satisfaction the competitive demand for capital and the conditions under which capital was found during the years covered by the exhibit, namely, 1936, 1937 and 1938 (R. Vol. III, p. 1422). The average rate of return earned by all the companies listed was, in the year 1936, 9.30%, in 1937, 8.37%, and in 1938, 4.37%, or a three year average of 7.32%. Excluding the companies which over the period earned an average of less than the average of all companies, the remaining companies, which had an investment of somewhat more than $924,000,000, returned an average of 11.73% per annum (R. Vol. III, p. 1423).

The witness emphasized that the point in a rate of return study is not to determine the cost of financing and underwriting the best debt that the company has, but that it is necessary to arrive at the cost of financing its entire capital structure, including its preferred and common stock (R. Vol. III, pp. 1429-30). The overall earnings of Columbia's securities for 1938 amounted to 3.78%. In 1939 the earnings had increased to 4.25%. Notwithstanding its low earnings, however, the Columbian system, with assets aggregating $573,500,000, would be able, in the witness' judgment, to refinance its total indebtedness of $101,400,000 on a basis that would effect a substantial interest saving as compared with the interest on outstanding bonds, issued several years ago, bearing 5% (R. Vol. IV, p. 2563). That the low rate of interest at which the bonds could be refinanced is no criterion by which to judge the rate at which the preferred stock and common stock could be refinanced is evidenced by the circumstance that Columbia's 6% preferred

stock was selling currently at a discount of 10%, that its 5% preferred stock was selling at 72, and that its common stock was selling at less than half of its book net worth (R. Vol. IV, pp. 2667-8). Stating his reasons, he testified that in his judgment preferred stock has no place in the financial structure of a natural gas pipeline company (R. Vol. IV, p. 2569). In the light of all the facts reviewed by the witness, he arrived at the judgment that in order to keep cross-petitioners on a sound financial basis a return of 8% would be required.

The Testimony of Emery.

The second witness, Emery, an engineer, is senior vice president and member of the executive committee of Ford, Bacon & Davis, an engineering firm of national reputation, which has designed, constructed and operated natural gas pipelines and has had considerable experience in financing companies engaged in that business (R. Vol. III, pp. 1324-5). He testified to the risks inherent in the natural gas business as compared with those confronting ordinary utilities such as electric, manufactured gas or water distribution utilities (R. Vol. III, pp. 1452-9), and to the cost of financing natural gas companies (R. Vol. III, pp. 1460-4). He mentioned and discussed most of the particular risks above listed (R. Vol. III, pp. 1452-9). He pointed out the difficulty of making later adjustments through regulatory processes to correct any mistake made at the present time, due to the impossibility of increasing the rates in the face of competition with other fuels over the remaining few years of the project's life to offset losses occasioned by mistakes made now (R. Vol. III, p. 1454). He stated that he had made a search of market and financial records, had obtained a list of all natural gas companies having transmission lines, all the securities of which were dealt with so that market prices can be ob-

tained, and had found eleven companies which answered that description (R. Vol. III, pp. 1460-4).

He pointed out the distinction between a company which owns distribution facilities only and those which own facilities for producing and transporting gas, observing that there is less risk in the case of companies which distribute only, for which reason he did not include the latter in the list making up his studies (R. Vol. III, p. 1459). He reasoned that distributing companies have less risks than those having producing and transmission facilities because their property will be useful after the natural gas reserves are exhausted for distributing other kinds of gas, and that the distributing companies are less subject to competition than pipelines (R. Vol. III, p. 1459). He also pointed out that a transmission line owned by a distributing company is in a safer position than a pipeline confined to transmission and producing operations (R. Vol. III, p. 1459).

He produced Exhibit 148 (R. Vol. VI, pp. 3079-3104, Vol. III, p. 1465), showing the list of eleven companies above referred to. The exhibit is self-explanatory. In the first three columns after the listing of the companies and the statement of classification are shown the market appraisal of the value of the securities at the high price, at the low price, and at the average between the high and the low price, for the year 1938. The next column shows the earnings in 1938 applicable to return on investment, and the next three columns show the rate which the earnings bear to the market appraisal at the high price, at the low price, and at the average price (R. Vol. VI, p. 3081). It appears from the summary of the first page that the overall rate of return or demand of the public for the investment of money in these eleven companies, based on 1938 earnings and 1938 appraisal on quotations, was 7.98% (R. Vol. VI, p. 3081).

The exhibit is very significant in that it shows the distinction which the public makes in the risks involved in the various phases of the natural gas business. It appears that the public makes a substantial distinction between pure pipelines which have transmission facilities only and a pipeline which owns production in addition to transmission facilities. It also shows that the public is willing to take substantially less compensation for an investment in the securities of those companies owning distribution facilities, and that it makes a substantial distinction between the return demanded on securities in transmission and distribution companies and those which own production in addition to transmission and distribution facilities (R. Vol. III, p. 1463). The only company fitting the status of cross-petitioners entirely is Interstate Natural Gas Company, a production and transmission company, on whose securities the public demanded an overall return of 10.04% per annum. In the case of three transmission companies owning no production, the average rate of return required was 9.06%. Of the six companies owning distribution facilities also, it developed that for investments in the four which owned production as well as transmission facilities the public demanded a return of 7.55%, while in the instance of the two companies owning only transmission and distribution facilities it demanded only 7%. For the four pipelines owning no distribution facilities the unweighted average return was approximately 9.5%, or a weighted average of 9.3% (R. Vol. III, p. 1463). It was the judgment of this witness that the required rate of return for cross-petitioners was between 9% and 10%, if adequate compensation for creative skill, engineering, and exceptional management be included. If the rate of return cover only pure interest and compensation for risk, without any allowance for enterprise, his judgment was that not less than 8% would be required to attract the capital necessary to purchase the properties of cross-petitioners. (R. Vol. III, pp. 1470-1).

The Testimony of Gilman.

The third witness, Gilman, was for five years employed by Equitable Life Assurance Society, one of the five largest insurance companies in the United States, which invests many millions of dollars in securities each year (R. Vol. III, p. 1472). His duties were to investigate and make trips over and studies of the properties of public utilities and industrial companies, prepare reports thereon, and make recommendations to the treasurer and financial committee with reference to possible investments in their securities (R. Vol. III, p. 1472). In 1935 he organized, and for two years he directed, the Division of Public Utilities of the Securities and Exchange Commission (R. Vol. III, p. 1474). The staff, under his direction, numbering about one hundred persons, handled all the various applications filed with the Commission for registration of utility companies and their subsidiaries in connection with the issuance of securities, acquisition of assets, and all other related matters coming within the jurisdiction of the Commission under the Holding Company Act (R. Vol. III, p. 1474). After two years he left the employ of the Securities and Exchange Commission and returned to New York to enter the partnership of Gilman & Hickey, a firm practicing as financial consultants, primarily in the public utility field. They have appraised securities for public bodies and performed other services generally coming within the functions of consultants in financial work.

He has made considerable study of the subject of rate of return in connection with such employments; and in preparation to testify in this proceeding he made an exhaustive study of the affairs of cross-petitioners and the risks confronting them. He prepared and offered Exhibit 150 (R. Vol. VI, pp. 3106-3133, Vol. III, p. 1511), which contains financial data of various types considered by him to be of importance and value in checking his judgment as

to a proper rate of return for cross-petitioners. He discussed the hazards which exist from an investor's point of view in cross-petitioners' natural gas production and pipeline enterprise. He maintained that the electric industry is a much safer industry from an investor's point of view than any of the natural gas industries (R. Vol. III, p. 1494). Step by step he demonstrated the increasing risks, in comparison with those confronting the electric industry, of (1) the businesses of manufacturing and distributing artificial gas, (2) distributing natural gas, (3) producing, transporting and distributing natural gas, and (4) producing and transporting natural gas with no distribution facilities or control over the policies involving sales to the ultimate user of natural gas (R. Vol. III, pp. 1494-1500).

He maintained that preferred stock has no place in the capital structure of a natural gas pipeline company, explaining in that connection that the bondholders always require that the latest maturity of bonds be substantially short of the estimated life of the source of supply (R. Vol. III, p. 1505). After making provision for the retirement of the bonds over such short period, the company ordinarily earns insufficient revenues to pay the interest on preferred stocks, rendering that class of securities undesirable from an investor's viewpoint (R. Vol. IV, pp. 2469-70). He explained that the yield on natural gas pipeline company bonds, representing only 40% to 50% of the total capitalization, with the high protection afforded by the amortization provisions, is no criterion by which to gauge the return that would be required by investors in common stock (R. Vol. IV, pp. 2608-9). In this connection he pointed out that few public issues of common stock have been floated in the natural gas pipeline industry (R. Vol. III, p. 1482). In the light of his experience covering the handling of securities from the viewpoint of the purchaser, the public, and the seller, the witness arrived at the judgment that, in view of the various risks and hazards con-

fronting cross-petitioners, a reasonable or fair rate of return to them should not be less than 8% (R. Vol. III, p. 1504).

Called in rebuttal, the witness contradicted the views of complainant's witness Kleinman on the subject of risks (R. Vol. IV, pp. 2607, 2611-14). He also testified in rebuttal to some of the deductions of the Commission's witness Smith on the subject of overall cost of capital, to which it will be necessary to refer later in this brief (R. Vol. IV, pp. 2502-2505).

The Testimony of Dorau.

Cross-petitioners' fourth witness, Dr. Dorau, is an outstanding scholar and educator in the field of economics as applied particularly to public utilities and regulated enterprises. He has taught in the University of Wisconsin and in Northwestern University. In 1931, after engaging for two years in consulting work, he entered New York University, where he is now professor of economics and chairman of the department of public utilities and transportation in the School of Commerce. Throughout his teaching career he has engaged in consultation work to the extent that his university appointments permitted (R. Vol. III, p. 1513). He is the author of a number of books and published articles dealing with the subject of public utility financing and related subjects (R. Vol. III, pp. 1514-16). In order to prepare himself to express a considered opinion as to a just and reasonable rate of return for cross-petitioners, the witness made an exhaustive investigation of cross-petitioners' problems (R. Vol. III, pp. 1516-17). He pointed out that past investments are helpless before a harsh regulatory policy, but that such a policy would hurt the industry because it would discourage future investments and impair the power of the industry to attract additional capital (R. Vol. III, pp. 1542-3). On the other

hand, he pointed out, if regulatory bodies recognize the desirability of holding out to prospective investors the possibility of substantial reward, it does not necessarily follow that rates will be higher; for rigid regulation, by repelling the investor, sometimes results in higher capital costs and hence in higher rates. His analysis of the risks, which was thorough and painstaking, led him to the conclusion that the natural gas pipeline industry, which depends for its very existence upon the continuance of its source of supply, is a highly hazardous business in comparison with other regulated industries (R. Vol. III, pp. 1551-1585).

In arriving at his final judgment as to a fair rate of return for cross-petitioners, Dr. Dorau considered, among other things, data set forth in Exhibit 152 (R. Vol. VI, pp. 3141-3304, Vol. III, p. 1622), which he prepared. This exhibit stands out particularly in that it presents the subject matter covered with such clarity that it speaks for itself, *and also in that no effort was made by complainant and the Commission to refute the facts reflected by it or even to cross-examine the witness concerning its contents.* One of the significant facts reflected by Exhibit 152 appears on page 7, which shows, among other things, the ratio of the yield on Baa bonds to that of Aaa bonds, which are of a substantially higher grade. The curve indicating that ratio is strong evidence, according to the witness, that "investors are placing a relatively higher significance on the risk differentials that exist" than in former years (R. Vol. III, p. 1595). We urge the Court to consider carefully this exhibit and the testimony of the witness in explanation of its contents (R. Vol. III, pp. 1591-1622). It is practical here to present only some of the high points.

Among the outstanding facts manifest from this exhibit are: (1) Since 1934 the yield on manufactured gas company bonds has been increasingly higher year by year than

that of gas and electric company bonds (p. 10, R. Vol. VI, p. 3159). (2) The yield levels on all natural gas company bonds except the best quarter of the total volume "are not comparable with the experience of public utility securities" (p. 19, R. Vol. VI, p. 3177). (3) The overall weighted average yield of natural gas company bonds through the period 1928 to 1939 was 8.71% (p. 19, R. Vol. VI, p. 3177). (4) The yield at offering price on new electric and gas company bonds (not necessarily new financing) from 1932 through 1938 declines from year to year; but this curve is subject to misuse and misinterpretation, especially in view of the fact that "the yield might be declining simply because a larger proportion of the kind of bonds that yielded less were included" (p. 35, R. Vol. VI, p. 3209). (5) A much larger proportion of low yield or high class bonds has been included in the bond transactions in recent years (pp. 37, 38 and 50, R. Vol. VI, pp. 3213, 3215 and 3233). Thus "to a measurable extent the declining average yield in new financing was influenced by the changing quality of the securities which were included in the total" (R. Vol. III, p. 1617). (6) The yield on bonds issued by a company is in itself little evidence of the company's ability to command capital or of the hazard involved in an investment in the enterprise; for if the amount of the bonds in question, together with the amount of equal and prior security issues, is so small that the interest requirements are covered many times by the income, the yield will compare favorably with the yield on securities in less hazardous enterprises in which a larger proportion of debt results in the requirement of a larger percentage of available income for payment of interest. Therefore, yield ought to be related to earnings times interest coverage.

Such relation is shown by the exhibit (pp. 52, 53, 55, 56, 59, 60, 62, 63, 65, 66, 68 and 69, respectively, R. Vol. VI, pp. 3237, 3239, 3243, 3245, 3251, 3253, 3257, 3259, 3263, 3265, 3269 and 3271). (7) These charts and those on pages 72,

74, 76, 78, 80, 83, and 85, respectively (R. Vol. VI, pp. 3277, 3281, 3285, 3289, 3293, 3299 and 3303), show that, given comparable coverage, the yield on natural gas company securities is higher than the yield on public utility securities, and that, where the yields are comparable, the coverage on natural gas company securities is higher. From this it seems clear that investment in natural gas securities is regarded as relatively hazardous. The witness' conclusion is summarized in these words (R. Vol. III, p. 1623):

> "I would like to put my answer this way, if I might, that if there were an enterprise engaged in the natural gas business, having a large, substantial investment in natural gas resources and in specialized transportation facilities, which company had the protected position and status of a public utility, that I would consider 8% an adequate return, but I am of the opinion and conviction that the Natural Gas Pipeline Company of America and Texoma Natural Gas Company do not qualify economically as a public utility, that the conditions and circumstances of their operation are not comparable to what is found in a public utility, and that those distinguishing economic conditions deserve recognition, in fact must be recognized, in my opinion, if one is trying to judge what the necessary supply price of capital today would be for an enterprise of that character. Moreover, assuming that there is recognition to be given to the reward of enterprise in an undertaking of this sort, and that there is a desire to compensate and induce enterprise, I feel 9% is a more appropriate and fair return."

The Witnesses for the Commission and Complainant on Rate of Return.

The Commission and complainant offered four witnesses on rate of return, namely, Knapp and Smith, employees of the Commission, and Ostrander and Kleinman, employees of complainant. All are expert accountants (R. Vol. IV, pp. 2004, 2041-2, 1977, and 2075). None has had any ex-

perience in the issuance, purchase, or sale of natural gas securities or any other securities (R. Vol. IV, pp. 2109, 2225, 2281-3, and 2386-7).

The Testimony of Knapp.

Knapp's testimony had to do principally with Exhibit 185 (R. Vol. VII, pp. 3576-3723, Vol. IV, p. 2038), a volume devoted entirely to statistical matter relating to bonds and some preferred stocks of utilities, mostly electric utilities but including some artificial gas, water and telephone companies, and some general statistics relating to wholesale commodity prices, industrial production, steel ingot production, building contracts, national income, cost of living, trend of corporate earnings, interest and rediscount rates on short term high class loans, and similar data. There is no substantial conflict between the statistical matter submitted in this exhibit and that submitted by witnesses for cross-petitioners. Explaining his failure to include data on common stock transactions similar to that on bond transactions, he stated that he had made an attempt to compile new common stock issues but that he had found no representative issues (R. Vol. IV, p. 2111). He admitted that it has been very difficult to refinance through issue of common stock; that the fact that there have been comparatively few common stock issues in the last few years was attributable to the circumstance that investors have been primarily concerned recently with safety and security of investments, which would naturally lead them into bonds; and that they have been running away from risk in the making of their investments (R. Vol. IV, p. 2111). The witness admitted that his Chart 1 (R. Vol. VII, p. 3579) shows that there is a wider spread between the yields on the highest grade bonds and those on the lowest grade bonds at the present time than in 1932 or any year during the interval, and that this illustrates that investors are demanding a

higher differential as risk compensation than in prior years (R. Vol. IV, p. 2125).

He admitted on cross examination concerning interest rates on short term or demand loans and United States Treasury bonds that there is a great deal of idle money in this country, the owners of which are not willing to invest it in the light of the compensation promised for the risk involved; that this congestion of money which is available for the type of loan portrayed in his charts has resulted in reduced interest rates (R. Vol. IV, pp. 2128-9). He admitted that the owners of money are seeking temporary investments in order to obtain some return, however low, pending the time when they can find an outlet that will offer a return more to their liking; and that there is so much capital seeking investment in absolutely liquid securities that the interest rate on that type of security has been driven down to the lowest level in the history of the country (R. Vol. IV, p. 2130). Asked on cross-examination to point out the factors that ought to be considered in a rate of return study, the witness named (R. Vol. IV, p. 2118) the ten elements enumerated by the staff of the Federal Communications Commission in "The Problem of Rate of Return in Public Utility Regulation," etc., dated June 15, 1938, among which was:

> "The return should accomplish, among other things, due recognition of efficiency or lack of efficiency in management."

The Testimony of Ostrander.

The testimony of Ostrander, in so far as it dealt with subjects related to rate of return, had to do principally with statistics of the same general character as those presented by Knapp in his exhibit. Exhibit 180 (R. Vol. VII, p. 3523, Vol. IV, p. 1984) dealt with interest rates and trends of interest on prime commercial paper, prime bankers' ac-

ceptances, 90 day time loans, interest rates charged customers in 36 principal cities, discount rates in New York and Chicago Federal Reserve banks, yields on "long term" Federal and municipal bonds, on ten *high grade* railroad bonds and on ten *high grade* utility bonds, and yields on domestic corporation bonds by industrial groups and ratings (R. Vol. VII, pp. 3523-3534). This exhibit shows, as did Knapp's Chart 1 in Exhibit 185 (R. Vol. VII, p. 3579) and Dorau's chart on page 7 of Exhibit 152 (R. Vol. VI, p. 3135), that at the present time the investors demand a higher differential to compensate for risk than they did in earlier years. Exhibit 183 dealt with statistics showing the total number of banks in the country over a period, the number of banks belonging to the Federal Reserve system, deposits in the banks, and similar data (R. Vol. VII, pp. 3559-3565, Vol. IV, p. 2002). Exhibit 181 is a running narrative statement dealing with recent financing through bonds by natural gas systems. No fault is found with that data; but it is apparent from a reading of the exhibit that it does not go far enough to indicate anything as to the overall cost of capital to natural gas companies or to reflect any other data bearing upon the compensation which investors demand for the risks involved in natural gas securities other than bonds (R. Vol. VII, pp. 3535-3552, Vol. IV, p. 1896).

The witness admitted that it would be just as important to determine the cost of raising the equity capital by common stock issues as to ascertain the cost of raising that part obtained through the issuance of bonds (R. Vol. IV, p. 2298); that full information concerning bond yields does not give sufficient information to arrive at the cost of overall financing of a given industry (R. Vol. IV, p. 2298); that the matter of cost of equity money is quite a different thing from the cost of bond money (R. Vol. IV, p. 2298); that it is difficult to determine the cost of equity money, and that to obtain a reasonable cost figure would involve a rather

extensive study over a period of time (R. Vol. IV, pp. 2298-9); that no such figures are readily available (R. Vol. IV, p. 2299); and that he was not sure of any method of appraising the relation between bonds and stocks as regards cost (R. Vol. IV, p. 2299).

He testified that in financing through issuance of bonds there is a spread of about .2% between the yield to the investor and the cost to the company, though he admitted that he had known of its going as high as .4%. He also admitted that there would be a spread between the price earnings ratio of stocks sold in isolated transactions and the cost of financing through the issuance and sale of whole issues of common stock.

It is manifest that no basis for the finding of the Commission that 6½% per annum is a fair rate of return for cross-petitioners can be found in the testimony of the witnesses who testified for cross-petitioners or in the testimony of the witnesses Knapp and Ostrander, who testified against cross-petitioners.

The Testimony of Kleinman.

Of the four witnesses who testified for the Commission and complainant on subjects going to rate of return, only Kleinman, an employee of complainant, offered an opinion as to the proper rate of return in this case. He testified that 6% would be an adequate rate of return for cross-petitioners (R. Vol. IV, p. 2097). *This witness made no effort to relate his testimony to the exhibits prepared by Knapp, Ostrander and Smith. There is no evidence that he had even read them. He prepared no studies of his own dealing with the cost of capital or yields to investors among regulated industries or unregulated industries.* There is no evidence of an effort on his part to work out in any way the overall costs of financing for companies such as cross-petitioners. He gave no consideration to the enterprise of cross-peti-

tioners and their founders in the conception and launching of their pipeline system, their creative skill in designing and engineering efficiency, or the extraordinary management, which have entered so largely into the success of cross-petitioners. Pressed on cross-examination, he admitted that he had made no formal study, stating in that connection that he had "given considerable thought" to the question of whether these companies should get a better return than other companies, whether this type of industry deserved a greater return or lesser return than large distributing utilities like Commonwealth-Edison or scattered distributing utilities like Central Illinois Public Service Company.

In his direct testimony Kleinman defined his conception of risk in business as something arising out of a decision which must be made by the management and which, when made, will affect the subsequent profits realized by the business (R. Vol. IV, p. 2082). The witness also mentioned a number of risks which, he contended, confront manufacturing plants, mercantile establishments and other unregulated business enterprises, but which do not confront cross-petitioners to any perceptible degree. He named in this connection the risk of converting cash into inventory, the risk of labor disturbances, the risk of overhead expense, credit risk, risk of competition between rival concerns for the same market with the same product, and risk due to technological changes (R. Vol. IV, pp. 2082-8). We do not know why the witness went into this subject, as no comparison was made by any of cross-petitioners' witnesses between the rates of return earned by unregulated industry and that to which cross-petitioners are entitled, the data dealing with that subject having been offered for purposes of orientation only, as already shown. Kleinman made no use of this data in arriving at his ultimate judgment. He did not produce and offer in evidence figures showing what the earnings of unregulated industries were or how much

he had deducted from the level of such earnings in order to arrive at a proper return for cross-petitioners.

Kleinman knew nothing about the risks confronting the natural gas producing and pipeline business, much less about those confronting cross-petitioners. He did not discuss or attempt to refute the risks confronting cross-petitioners as outlined by their witnesses. He could not state how many pipelines were producing gas in the Panhandle field and transporting it in interstate commerce. He thought there were five (R. Vol. IV, p. 2423). As a matter of fact, the record had shown for several months that there were nine (R. Vol. I, pp. 629-30). He didn't know whether large investments were made in and around the Indiana gas field on the strength of the large reserve of gas believed to be contained in that field in the latter part of the last century (R. Vol. IV, p. 2426). He knew nothing about the recent failure of the Tioga field in southern New York (R. Vol. IV, p. 2427). He didn't know that the Illinois Senate had actually passed a bill levying a five cent tax on each thousand cubic feet of gas sold in Illinois (R. Vol. IV, 2457). That the witness was thoroughly biased and was giving expression to this bias and to prejudice against cross-petitioners is apparent from his own admissions on cross-examination. He took the absurd position that the business of cross-petitioners involves much less risk than that of ordinary business, notwithstanding the fact that courts and commissions and the public generally have recognized for many years that of all regulated industry the natural gas business is the most hazardous. He asserted that cross-petitioners are entitled to a lower rate of return than most electric utilities, basing that statement on his assertion that they have substantially less risk than most electric utilities. To use a specific sample, he pointed out Commonwealth Edison Company, asserting that it was an infinitely more risky enterprise than that of cross-peti-

tioners, although it is a well known fact that that company is one of the strongest electric utilities in the country (R. Vol. IV, p. 2485). In this connection the witness said (R. Vol. IV, p. 2466):

> "I hope Mr. Morgan understands what I mean now in general. In other words, they have got 40 years to go. They have a risk until they go broke, because that is the end of all corporations, except yours, Mr. Morgan, because you are going to get your money back in 1954. Most corporations will ultimately wind up in bankruptcy. It happens to most of them. They cannot liquidate. Just as the end of most people is death, the end of most corporations is bankruptcy. But not yours. You will have your money back in 1954, maybe twice over. That is the reason I say that your company has less risk than the Commonwealth Edison."

What is Kleinman's objective? Does he want to put cross-petitioners in a situation where they too will go bankrupt? Is that regulation as Kleinman sees it?

On being pressed as to how he arrived at 6% as the proper rate of return, he stated (R. Vol. IV, p. 2467) that he got it primarily on the basis of what he thought cross-petitioners "could finance at, what I thought this company could sell its stocks and bonds for." He added (R. Vol. IV, p. 2467):

> "I made a few rough calculations and decided it would be a good company to finance with serial bonds, and what would they require, and then common stocks for the balance, and what would that take, and, as I remember it, I originally got about 4¼%, and *I upped it.*"

He doesn't tell us what kind of rough calculation he made or what he used as the basis of that rough calculation. It must have been extremely rough and the data must have been extremely meager in order for him to arrive at any such result as that in the light of the factual testimony then in the record.

Pressed further as to why he "upped it" from 4¾% to 6%, he said (R. Vol. IV, pp. 2467-8):

> "No, I did not, not from 4¾% to 6. From 4¾% to about 5½, for other factors, leeway, and to bring it some place, and finally I said there is a war on and I don't know whether they can do it for seven years, because when I was making this study the war was on and there had not been any security issues, prices were going haywire, nobody knew the future, and from the point of view of being absolutely sure that I was giving a liberal return, one that I could substantiate from any point of view, I finally decided on 6%, with a rough guess, and that certainly under the worst condition now prevailing this company's securities would sell at par, if their bonds are paying 4% and their stock is paying 8%, and I don't think anybody can deny that."

On further cross-examination the witness admitted that the fact that many electric utilities and some gas distribution companies had been allowed a 6% return and that he had grouped cross-petitioners among public utilities had something to do with his judgment (R. Vol. IV, p. 2468). He had already admitted that the Illinois Commerce Commission had recently allowed an electric utility a return of 6.3% (R. Vol. IV, p. 2466).

The state of the witness' mind is disclosed in his testimony (R. Vol. I, p. 2468), reading:

> "* * * You are right, I made no distinction between the character of these two pipelines, from the standpoint of the risks involved, and of electric utilities and of the distribution utilities, except that I reached the conclusion that they have less risks or fewer risks than do those distributing utilities. I did make a distinction. The distinction was that they are entitled to a lower rate of return than an electric utility or a gas utility."

Surely the Commission gave no weight to the testimony of this witness, though it mentioned in its opinion (R. Vol. VIII, p. 3940) that one of the witnesses testified that 6%

would be an adequate return. We insist that this testimony is not "substantial evidence" in the sense that it sustains the Commission's finding.

The Testimony of Smith.

It is perfectly apparent from the Commission's opinion that the real basis of the rate of return fixed was the testimony of its employee Smith. This witness has had a number of years' experience as an auditor in the United States Treasury Department, as chief auditor of the Public Service Commission of Maryland, and as a teacher for ten years of accounting and cost accounting (R. Vol. IV, p. 2042). His title with the Commission is chief of the bureau of accounts, finance and rates (R. Vol. IV, p. 2041). Smith did not testify as to a reasonable rate of return, or to facts as to any of the elements which must be considered in arriving at a fair rate of return, except that he did testify to *cost of capital* to certain natural gas companies listed in his Exhibit 186 (R. Vol. VII, pp. 3739-83, Vol. IV, p. 2072). This exhibit shows a list of all the natural gas companies having the characteristics: (1) were engaged in the production and transmission of natural gas, or (2) were engaged in the transmission of natural gas, and (3) had operating revenues in 1938 of $2,500,000 or more (R. Vol. VII, pp. 3740-5, Vol. IV, p. 2050). A number of these companies were engaged also in distribution, but all were engaged in transmission or in transmission and production of natural gas (R. Vol. IV, p. 2050).

The data contained in Schedule 5 are too general and incomplete to be of real service. Some general facts appear, however, which we think it worth while to point out. Of the total securities outstanding, aggregating in excess of $1,038,000,000, $418,882,000, or about 40% of the total, is represented by bonds, debentures and notes, $607,000, or 6% of the total, is represented by preferred stock. Of the

total outstanding securities $729,000,000, or 70%, is held by affiliates, and only about 30% by the public, including institutions. Two important facts are indicated by these figures. First, the small representation of preferred stock corroborates the testimony of the witnesses Gilman and Delafield to the effect that the use of preferred stock in raising capital for natural gas companies is not practical or desirable (R. Vol. III, pp. 1681-2, Vol. IV, p. 2569). What people are willing to do is best indicated by what they do. The fact that this great industry has been able to finance only 40% of its total capitalization through the issuance of bonds and other funded indebtedness and only 6% by preferred stock indicates that that is all the investors are willing to invest in funded indebtedness and in preferred stocks. We point out in this connection that the bonded indebtedness is far less than 40% of the total capitalization. Smith testified that the bonded indebtedness was substantially 20.83% of the total capitalization (R. Vol. IV, p. 2262). The fact that only 30% of the securities have been purchased by the public is highly significant as indicating the difficulty of inducing the public to invest their moneys in the securities of natural gas companies at the existing levels of compensation.

Schedules 5A (Vol. VII, p. 3747), 5D (Vol. VII, p. 3763), and 5F (Vol. VII, p. 3767) are of special significance in that it was on these exhibits and the witness' testimony explaining them that the Commission based the statement in its opinion (R. Vol. VIII, p. 3939) that the cost of money to a sound pipeline company would be 3.75% for the bonds, 6.1% for the preferred stock, and 10% for the common stock. Schedule 5A (R. Vol. VII, p. 3747) contains several inaccuracies and is defective in that certain essential data are omitted. The result is that the schedule is entirely misleading. In the first place, in showing the approximate yield to maturity on the basis of 1939 prices, the "times

fixed charges earned" should have been ascertained over the latest twelve months for which the figures were available at the time of the sales in September and October, 1939. The percentages used by the witness were based on the earnings for 1938. It is a matter of common knowledge that 1938 was a bad year from the standpoint of earnings, and that earnings materially improved during the first half or two-thirds of 1939. These increased earnings were known to those who purchased securities in September and October, 1939, and doubtless influenced the price which the purchasers were willing to pay during those months (R. Vol. IV, p. 2502). Not only should the figures have been based on the latest available published earnings, but it is totally misleading to use the figure representing "times fixed charges earned" in dealing with the yields on first mortgage bonds. An investor negotiating for the purchase of first mortgage bonds is not interested in the relation of the total earnings to the fixed charges, but is concerned only with the earnings in their relation to the interest on the particular issue of bonds under consideration and prior issues (R. Vol. IV, p. 2253). We may illustrate the difference from this schedule itself. For instance, in the case of *Houston Gulf Gas Company,* the earnings times fixed charges is stated to be 1.3. The interest on the first and collateral 6% bonds, on which the approximate yield to maturity is stated to be 5.13%, was very substantially less than the total fixed charges. When applied to the interest on these prior issues, it develops that the earnings times interest is 3.03 instead of 1.3 (Exhibit 209, R. Vol. VII, p. 3895, Vol. IV, p. 2504), from which it is apparent that the investor demanded 5.13% return on an issue of bonds the interest on which is earned more than three times. It is manifest that he would not have been willing to invest for that sort of yield had the coverage been only 1.3.

Another defect in this schedule is that the percentage of

total property represented by the issue is not shown. Only the percentage of the total funded debt to fixed capital is set out in the schedule. It developed, however, that the total first mortgage issue represented only 23.24% of the fixed capital (Exhibit 209, R. Vol. VII, p. 3895, Vol. IV, p. 2504). Certainly an investor would regard a first mortgage bond issue representing only 23.24% of the capital as a safer security then one representing 43.8% of the fixed capital.

These discrepancies were called to the attention of the witness on cross-examination, as will appear from his testimony as follows (R. Vol. IV, p. 2250):

> "The $4,238,000 of First and Collateral Six Percent Mortgage Bonds, maturing in 1943, are undoubtedly senior to the Debentures, due at the same time. In showing there the times fixed charges earned in 1938 these senior bonds are grouped with the debentures. We would get a different result if we were to calculate the times interest on the First Mortgage Bonds. I wish we had the figure. We could not get it at the time this figure was prepared. We had the earnings and the income statement. We took the total interest requirements and that was covered 1.30 times. We did not have the interest in the income statement broken down. There may be some difference between the interest in the income statement and the interest on these particular items. It is simple enough to calculate interest on $4,238,000 at 6 per cent if those bonds were outstanding in that amount all the year. This 1.30 does not apply to the First Mortgage Bonds; it applies to the two issues, and we show that very clearly.
>
> "A purchaser interested in buying some of those First Mortgage Bonds would concern himself about the coverage for the First Mortg[illegible]e Bonds only."

As a matter of fact, Exhibit 209 (R. Vol. VII, p. 3895, Vol. IV, p. 2504) shows that this coverage of 1.3 did not apply only to the interest on the first mortgage bonded

indebtedness and the debentures, but also to a substantial amount of other junior indebtedness.

To cite another example of the misleading character of this schedule as it was originally put in, take the instance of the Oklahoma Natural Gas Company bonds shown in line 4. These bonds were issued in August, 1939, and of course they were not sold upon a "times fixed charges earned" of 1.91 for the year 1938 when the company had different securities outstanding from the bonds that were sold in 1939. As a matter of fact, based on the *pro forma* earnings statement for the twelve months ending August 31, 1939, interest on the new bonds which were sold to yield 3.55% was covered, not 1.91 times, but 4.53 times, and all fixed charges of the company were covered 3.25 times (Exhibit 209, R. Vol. VII, p. 3895, Vol. IV, p. 2504). Certainly an entirely misleading deduction would be made from this exhibit if it were assumed that the investor who purchased bonds of that company on September 30, 1939, at an approximate yield to maturity of 3.55% did it in the face of the circumstance that the times interest earned was only 1.9 instead of 4.53. Again, "percent of the total fixed capital" is stated to be 56.87, but when applied to the issue of mortgage bonds under consideration it turns out that the bonds actually represented only 38.8%.

Cross-petitioners caused a careful study of the full facts affecting these issues of bonds to be made and offered in evidence as Exhibit 209 (R. Vol. VII, pp. 2895-9, Vol. IV. p. 2504). The approximate yields to maturity are not substantially different in the two studies; but Exhibit 209 portrays the correct picture in that it shows that the actual earnings times interest coverage of the particular issues and the actual property coverage in each instance were substantially higher than the times fixed charges earned and the property coverage of all funded debt as reflected by the Smith exhibit. In other words, the investors, who

purchased these securities on a basis of an approximate average yield to maturity of about 4%, invested their money in the light of the actual earnings times interest requirements and the actual property coverage, and no doubt would have demanded a higher yield had the property coverage or the earnings times interest been less.

Schedule 5D (R. Vol. VII, p. 3763) is subject to the same criticism as Schedule 5A. It deals with issues of preferred stock by four gas companies. It indicates a times dividend requirements earned and times fixed charges and dividends earned in 1938, and compares those earnings with the prices paid for this preferred stock in transactions on September 30, 1939, at which time, as already pointed out, the earnings had materially improved and published information was available to investors showing these improved earnings. Page 2 of Exhibit 209 (Vol. VII, p. 3837) shows the facts omitted.

Schedule 5F of Exhibit 186 (R. Vol. VII, p. 3767) is subject to the same defects as Schedules 5A and 5D. The result of the procedure used in the case of Schedule 5F is more distorted and misleading than in the case of the other two schedules. The witness computed the earnings price ratio by using, as he did in the other schedules, the 1938 earnings and the price as of September 30, 1939. Purchasers buying stock would, of course, avail themselves of the latest information on the subject of earnings. The earnings were available and had been published at much later dates than the end of 1938 and were substantially higher for the latest twelve months' period than for 1938 in most instances. For example, the figures used by Smith in his Schedule 5F (R. Vol. VII, p. 3767) showed the earnings of El Paso Natural Gas Company, at $3.30 per share. The latest published year's earnings at the time of the sales transactions reflected in Schedule 5F are shown to be $3.77 per share (Exhibit 209, R. Vol. VII, p. 3899, Vol. IV,

p. 2504). In the case of *Oklahoma Natural Gas Company* the earnings per share figure used in Schedule 5F was $1.70, whereas it appears from Exhibit 209 that the latest published figures were $2.56 per share. The Southern Natural Gas Company earnings per share figures used in Emith's exhibit were $1.37. Exhibit 209 shows that the latest published earnings were $1.79. In the case of those companies for which no later earnings statements had been published, an investor would doubtless have assumed that the earnings had improved in 1939 over 1938, and the price he was willing to pay was doubtless influenced by that circumstance. If the correct figures are used and if the two companies, Indian Territory Illuminating Oil Company and South Penn Oil Company, are taken out of the figures, as Smith himself stated they should be (R. Vol. IV, p. 2249), page 3 of Exhibit 209 (R. Vol. VII, p. 3839) shows that instead of a weighted average percentage of earnings to latest quotations of 7.33, the figure was actually 10.45!

At this point let us take the yields to the purchasers of bonds, preferred stock and common stock on the issue with which Schedules 5A (R. Vol. VII, p. 3747), 5D (R. Vol. VII, p. 3763), and 5F (R. Vol. VII, p. 3767) of Smith's exhibit deal, after supplying the omissions and correcting the erroneous figures used in Smith's exhibit, which omissions and corrections are reflected by Exhibit 209, and ascertain what it would cost to finance the capitalization of a natural gas company as indicated by those figures. Let us assume that the bonds represented 40% of the indebtedness, though Smith has stated that in the capitalization of the companies listed in his exhibit the bonds actually represented an average of only 20.83% of the total. Add to the 4% average yield reflected on page 1 of Exhibit 209 (R. Vol. VII, p. 3895) the .4 of 1% for cost of financing (R. Vol. IV, p. 2272), and it appears that the cost to the company for capital raised through bonds would be 4.4%.

Then take the 6% of the total capitalization represented by preferred stock, and add to the average yield to the public of 5.35% the cost of financing, which Smith testified would amounted to .4 of 1% (R. Vol. IV, p. 2272), or a total cost to the company of 5.75%. Then add to the 10.45 percentage of earnings on the common stock 15% for cost of financing by common stock (R. Vol. IV, pp. 2303, 2305), and it appears that such cost will be 12.01%. Thus it appears that of the total capitalization 40% will cost 4.4%, 6% will cost 5.75%, and 54% will cost 12.01%. Applying these figures to the total capitalization, it develops that the overall cost is 8.61%!

If the preferred stock be eliminated and the bonded indebtedness be assumed at 40% of the total capital and the equity capital at 60%, the overall cost would be 8.9%. If the bonded indebtedness be increased to 50% and the common stock be decreased to 50%, the overall cost would still be in excess of 8%. Even if Smith's own division of 40% to bonds, 20% to preferred stock, and 40% to common stock be used as the basis of computation, the overall cost to the company turns out to be 7.71%.

As we have already pointed out, Smith did not express an opinion or judgment as to a proper or reasonable rate of return for cross-petitioners. On cross-examination, however, he did volunteer that cross-petitioners would have no difficulty in financing at a low cost if they restrict their securities to a proper amount with reasonable ratio of bonds, preferred and common stock. He had testified that he had not the least doubt that the companies could finance on as favorable, if not more favorable, a basis than any other gas producing and transmission company in the United States.

That was a very far-reaching statement for a witness who made no pretense to qualifying as an expert on the subject of rate of return, or even on the subject of cost of

capital, to make. From that statement alone, a reader might easily get the impression that this witness had a very extended knowledge not only of what it had cost other natural gas production and transmission companies to obtain overall capital but also all the facts and circumstances going to the risks confronting the natural gas pipeline companies and those investing in their securities. Did the witness have such knowledge? His qualifying testimony shows that he has been dealing with ordinary utilities in his experience with the Maryland Commission and, prior to the enactment of the Natural Gas Act, with electric transmission and distribution companies since he has been with the Federal Power Commission. So imperfect was Smith's knowledge of the gas pipeline companies in general that in Exhibit 186 he listed among the thirty-one companies, with which he dealt in that exhibit, two companies which he himself later stated should never have been included (R. Vol. IV, p. 2249), one because it was primarily an oil company, and the other because it did not have any producing or transmission facilities. On cross-examination he was asked if he knew whether certain named natural gas pipeline companies were built prior to 1926. Of the twenty-six companies about which he was asked he was able to answer that question as to only nine companies (R. Vol. IV, pp. 2237-9).

His further utter lack of knowledge of the ordinary elements of risk, about which he would have to know in order to reach the conclusion he expressed in his voluntary statement above referred to, is reflected by his testimony on further cross-examination, from which we quote (R. Vol. IV, p. 2635):

> "You ask if I am familiar with the physical conditions encountered by each of those companies listed in Exhibit 186 under Schedule 5 and the subdivisions thereof which I have classified as producing and/or transmission companies. I was familiar with the source

of supply but as to the topography, I have a general knowledge that any person who has read some geography would know about it in the United States. I have just the information that I would get from an atlas, except I have been to some of those places. I have made no detailed study, of course. For instance, I have been up along the Mississippi Valley. I know something about the pipeline company which serves St. Louis in a general way from having seen the territory in an automobile and from a train window; but I would not know anything about the details of the physical structure of the earth, of the rivers, the detail of them, the depth, the width and so on."

We quote also (R. Vol. IV, pp. 2635-6):

"* * * Lone Star has a wider source of supply than the other companies you have mentioned. I would classify it as a network. You are going beyond my depth when you ask me whether it can switch gas from one part of its system to another to meet shortages and things of that kind. I don't know which of these companies are in position to do that.

"* * * * * *

"The Colorado Interstate runs north out of the Panhandle, up through the northeast corner of New Mexico, and on into Colorado. I do not know of any large rivers that that line crosses. I don't know anything about any topography of the country there that would indicate that there were any extraordinary hazards confronting that company.

"The Cities Service Company runs out of the Panhandle to Kansas City and also takes from other fields in Western Kansas and Oklahoma. I do not know whether it crosses either the Missouri or the Mississippi River. You are getting out of my field when you get down to the topography of the country through which these pipelines pass. I do not know whether it delivers the gas to the Kansas City Company on the east or the west side of the Missouri River."

That Smith does not have that information is no reflection on him as an accountant or statistician. He just

doesn't know the facts necessary to qualify him to express a judgment as to what it would cost cross-petitioners to refinance the value of their properties through the issuance and sale of securities. He may have read Moody's Manual and a dozen other publications of that character from cover to cover. He may have seen numerous reports and prospectuses concerning issues of securities. He may have audited the books of many companies and from that ascertained their earnings. But without practical experience in contacting the investing public and meeting the views and demands of investors, he cannot know, and does not know, what the attitude of the investing public would be if overall issues of securities were offered for sale by cross-petitioners. In the field of finance, as in the field of law or surgery, men must learn to do by doing. They cannc learn by looking on or by reading what others do. It is no reflection on a nurse who has seen a skilled surgeon perform a thousand delicate and difficult operations that she cannot qualify herself to practice in the field of surgery or to express an expert opinion concerning a surgical problem. Smith's opinion as to the overall cost to cross-petitioners of obtaining capital is just a guess of the wildest character. He makes no attempt to rest his statement in that connection on any factual basis. There is no connection between his opinion and the figures he brought in through his Exhibit 186. The latter figures, as we have shown, discredit his opinion and corroborate the opinions and judgments of the qualified experts who testified for cross-petitioners on this subject.

We submit, therefore, that, assuming a proper rate base, the finding of the Commission that a fair return to cross-petitioners would be 6½% per annum is not sustained by substantial evidence and that the Commission erred as a matter of law in so finding. Certainly the finding of the Commission that 6½% per annum is a fair return must

be set aside in view of the figures used by the Commission itself on page 24 of its opinion (R. Vol. VIII, p. 3939). Taking the figures at their face value, their effect is that cross-petitioners could refinance on a basis of 40% in bonds, 20% in preferred stock, and 40% in common stock at a cost of 3.75% for the capital raised through bonds, 6.1% for capital raised through preferred stock, and 10% for capital raised through common stock. On this basis the cost of $100.00 would be:

Amount	Security	Rate	Annual Cost
$ 40	Bonds	3.75%	$1.50
20	Preferred Stock	6.10%	1.22
40	Common Stock	10%	4.00
$100			$6.72

In this connection we point out that cost of capital is but one of the elements which must be considered, and that cross-petitioners must be allowed compensation in addition to the cost of capital to cover risk, creative enterprise, engineering skill, and exceptionally efficient management. A finding made in total disregard of the substantial and uncontradicted evidence going to these additional elements cannot be sustained. In the light of the evidence as a whole, we submit that the Commission erred as a matter of law in refusing to find that cross-petitioners are entitled to 8% as a minimum annual rate of return.

Since the finding of the Commission that 6½% per annum is a reasonable return on the rate base allowed is not supported by substantial evidence, it follows, of course, that the order based on such finding should be vacated and set aside.

VII.

The Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because the Commission Is Without Power and Jurisdiction to Enter an Interim Order.

A. *The Power and Jurisdiction of the Commission to Fix Charges for Natural Gas are Derived Solely from the Natural Gas Act.*

B. *By the Enactment of the Natural Gas Act, Congress Neither Conferred nor Intended to Confer on the Commission Power and Jurisdiction to Enter an Interim Order in the Midst of the Hearing.*

C. *The Order Entered by the Commission Under the Assumption That it Had Power and Jurisdiction Under the Natural Gas Act to Enter an Interim Order Is Void.*

(Sec. 8, Summary of Argument, *supra*, p. 64.)

Cross-petitioners were required to proceed with their testimony before the Commission and complainants were required to develop any evidence in support of their contention that cross-petitioners' existing rates are unjust and unreasonable (R. Vol. I, pp. 15, 24). Complainant and the Commission have never developed such evidence. At the conclusion of cross-petitioners' *direct* testimony, before 30 of their 37 witnesses had been cross-examined, the motion for an interim order was filed with the Commission by complainant and counsel for the Commission. The hearing before the Commission has not been concluded. The Commission in its order specifically directed:

> "The record herein shall remain open for such further proceedings as the Commission may deem necessary or desirable." (R. Vol. VIII, p. 3946.)

We submit that Section 5 of the Natural Gas Act requires that the hearing be completed before an order reducing

rates can be entered. Under the plain wording of the statute no authority is given the Commission to enter an order fixing rates until after the completion of a full hearing. There is no provision in the statute for the entering of an interim order.

It is elementary that a statutory commission being a creature of statute can derive no authority by implication or by common law. An order of a commission to be valid must be based upon some express provision or delegation of power made by statute (*State* v. *Sugar Land Ry. Co.*, 163 S. W. 1047, 1049 (Tex. Civ. App.)). In *Siler* v. *L. & N. Co.*, 213 U. S. 175, 194, this Court announced the same rule in a case involving the validity of an order of the Kentucky Railroad Commission fixing rates. In the opinion the Court said:

> "The Commission, as an extraordinary tribunal of the state, must have the power herein exercised conferred by a statute *in language free from doubt.* The power is not to be taken by implication; it must be given *by language which admits of no other reasonable construction.*" (Italics ours.)

The original Interstate Commerce Act required that all rates be reasonable, and delegated to the Interstate Commerce Commission power to determine whether or not existing rates were reasonable, but did not expressly authorize the commission to fix rates for the future. The commission sought to exercise the power to fix rates, however; but in *C. N. O. & T. P. R. Co.* v. *I. C. C.*, 162 U. S. 184, 196-7, this Court, in striking down the Commission's order, said:

> "We do not find any provision of the act that expressly or by necessary implication confers such a power.
>
> "It is argued on behalf of the commission that the power to pass upon the reasonableness of existing rates implies a right to prescribe rates. This is not necessarily so. * * * If the commission, instead of with-

holding judgment in such a matter until an issue shall be made and the facts found, itself fixes a rate, that rate is prejudged by the commission to be reasonable."

Discussing the same question in *I. C. C.* v. *C. N. O. & T. P. R. Co.*, 167 U. S. 479, 494-5, this Court said:

"The question debated is whether it vested in the commission the power and the duty to fix rates; and the fact that this is a debatable question, and has been most strenuously and earnestly debated, is very persuasive that it did not. *The grant of such a power is never to be implied.* The power itself is so vast and comprehensive, so largely affecting the rights of carrier and shipper, as well as indirectly all commercial transactions, the language by which the power is given had so often been used and was so familiar to the legislative mind and is capable of such definite and exact statement, that no just rule of construction would tolerate a grant of such power by mere implication." (Italics ours.)

Later the Court, in the same opinion, said:

"The vice of this argument is that it is building up indirectly and by implication a power which is not in terms granted. It is not to be supposed that Congress would ever authorize an administrative body to establish rates without inquiry and examination. • • • *And if it had intended to grant the power to establish rates, it would have said so in unmistakable terms.*" (Italics ours.)

Under the Natural Gas Act (15 U. S. C. 717 d) the Commission is directed to perform two functions, namely, to determine whether or not the various existing charges are unjust or unreasonable, a *quasi*-judicial function; and, in those instances where it shall find that the existing charges are unjust or unreasonable, to determine just and reasonable charges and fix the same by order, a *quasi*-legislative function. We have shown that under no circumstances does it have jurisdiction to set up a lower and different

charge until it has first performed its *quasi*-judicial function and made a finding, *after hearing pursued to point of final conclusion*, that the charges are unjust or unreasonable.

We have also shown that both the Commission and complainant have ignored the primary *quasi*-judicial function in that neither of them has offered any evidence showing that cross-petitioners' charges are unjust or unreasonable. All the affirmative testimony offered by them goes to the question of what is a fair and reasonable rate of return to cross-petitioners. In effect both assume that cross-petitioners' charges are unjust and unreasonable because, under their theory (which is erroneous, as we have shown), they determine that cross-petitioners' annual net revenues from operations exceed the amount they have allowed annually to apply on amortization and a 6½% return on the rate base which the Commission has fixed. Assuming that there is substantial evidence (which there is not) that 6½% per annum on the proper rate base would constitute a fair and reasonable return, such evidence would be no proof that the charges of cross-petitioners for natural gas are unjust and unreasonable. A charge may yield revenues in excess of an amount which would be fair and reasonable in the sense that it would not operate to confiscate cross-petitioners' property and at the same time not yield sufficiently in excess of that amount to constitute it an unjust and unreasonable charge.

The Commission, without waiting for complainant to offer any evidence, and without itself offering any evidence, showing that cross-petitioners' charges are unjust and unreasonable, proceeded at once with evidence looking to the construction of a new rate, and in that connection disposed of its *quasi*-judicial function by fiat in the form of a finding that the existing charges are unjust and unreasonable. This it cannot do in the midst of a hearing. The term "hearing" as used in the section of the Natural

Gas Act above cited, does not mean half a hearing, or any part of a hearing less than the entire hearing, including final arguments and briefs of counsel on the whole record developed by both sides of the controversy. "A full and fair hearing, a fair hearing, a formal hearing and a hearing all amount to the same thing in law." *Wisconsin Telephone Co.* v. *Public Service Commission*, 287 N. W. 122, 138.

For many years this Court has stressed the importance of allowing full, fair, and adequate hearings. Thus in *I. C. C.* v. *L. & N. R. R. Co.*, 227 U. S. 88, 91, 93, the Court said:

> "In the comparatively few cases in which such questions have arisen it has been distinctly recognized that administrative orders, *quasi*-judicial in character, are void if a hearing was denied; if that granted was inadequate or manifestly unfair; if the finding was contrary to the 'indisputable character of the evidence'."

The Court continued:

> "But the more liberal the practice in admitting testimony, the more imperative the obligation to preserve the essential rules of evidence by which rights are asserted or defended. • • • *All parties must be fully apprised of the evidence submitted or to be considered, and must be given opportunity to cross-examine witnesses, to inspect documents, and to offer evidence in explanation or rebuttal.* In no other way can a party maintain its rights or make its defense. In no other way can it test the sufficiency of the facts to support the finding." (Italics ours.)

In *Ohio Bell Telephone Co.* v. *Public Service Commission*, 301 U. S. 292, 304-5, the Court, in an opinion by Mr. Justice Cardozo, said:

> "Regulatory commissions have been invested with broad powers within the sphere of duty assigned to them by law. • • • All the more insistent is the need, when power has been bestowed so freely, that the

'inexorable safeguard' of a fair and open hearing be maintained in its integrity. * * * The right to such a hearing is one of 'the rudiments of fair play' assured to every litigant by the Fourteenth Amendment as a minimal requirement. * * * *There can be no compromise on the footing of convenience or expediency, or because of a natural desire to be rid of harassing delay, when* that minimal requirement has been neglected or ignored." (Italics ours.)

The pertinent portions of the statute on which the Commission relies for its authority here (15 U. S. C. 717 d) read:

"'Whenever the Commission, after a hearing * * * shall find that any * * * charge * * * is unjust, unreasonable, * * * The Commission shall determine the just and reasonable * * * charge * * * and fix the same by order. * * *"

It is inconceivable that Congress intended by the language above quoted to vest in the Commission the power to issue an interim order in the midst of a hearing. This language is not new, nor is it peculiar to the Natural Gas Act. The same language is contained substantially in the statutes dealing with the powers and duties of other regulatory bodies upon which Congress has placed the responsibility of regulating rates and charges.

The comparable portion of Section 13 (1), Title 49, U. S. C. A. (Interstate Commerce Act) reads:

"Whenever, after full hearing, * * * the commission shall be of opinion that any * * * rate * * * is or will be unjust or unreasonable * * * the commission is authorized and empowered to determine what will be the just and reasonable * * * rate * * * to be thereafter observed in such case."

The statute defining the powers and duties of the Federal Communications Commission (Section 205 (a) of Title 47, U. S. C. A.) reads:

"Whenever, after full opportunity for hearing,

> * * * the commission shall be of opinion that any charge * * * of any carrier or carriers is or will be in violation of any of the provisions of this chapter, the commission is authorized and empowered to determine and prescribe what will be the just and reasonable charge * * * to be thereafter observed."

The corresponding provision in the Packers and Stockyards Act (Section 211, Title 7, U. S. C. A.) reads:

> "Whenever, after full hearing, * * * the secretary is of the opinion that any rate * * * is or will be unjust, unreasonable or discriminatory, the secretary—(a) may determine and prescribe what will be the just and reasonable rate or charge * * *"

Also in the Motor Carriers Act (Section 316 (e), Title 49, U. S. C. A.) we find similar language:

> "Whenever, after hearing, * * * the commission shall be of the opinion that any individual or joint rate * * * is or will be unjust or unreasonable, * * * it shall determine and prescribe the lawful rate * * * thereafter to be observed."

In the act creating the Federal Power Commission (Title 16, U. S. C. A., Section 824 e(a) we find almost exactly the same language dealing with the authority of the commission to regulate electric power rates as that appearing in the Natural Gas Act:

> "Whenever the commission, after hearing * * * shall find that any rate * * * is unjust or unreasonable, * * * the commission shall determine the just and reasonable rate * * * to be thereafter observed and in force."

Just as in the Natural Gas Act the section from which we have quoted is preceded by a declaration that all rates and charges shall be just and reasonable and that any rate or charge that is not just and reasonable is declared to be unlawful, so in the case of each of the other regulatory acts above mentioned the section quoted is preceded by a

similar declaration by Congress. In each of these acts Congress declares, in substance, that whenever the commission charged with the duty of administering the act shall find, after hearing, that any rate collected by the concern subject to regulation is unjust or unreasonable, the commission shall determine the just and reasonable rate thereafter to be observed. It is significant that in all of the regulatory acts to which we have referred Congress included a provision similar to the provision in 15 U. S. C. 717 c(e) authorizing the commission to suspend the operation of a *new* rate schedule filed by a regulated company for a limited period pending investigation by the commission. In the Natural Gas Act the period is limited to five months (15 U. S. C. 717 c(e)). In the Federal Power Act the period is also five months (16 U. S. C. A., Sec. 824 d(e)). In the Packers and Stockyards Act the suspension period is fixed at thirty days (7 U. S. C. A., Sec. 207 (e)). In the Motor Carriers Act the suspension period is ninety days, with a special provision that it shall not apply to schedules filed on or before July 31, 1938, by a carrier in bona fide operation when the Act took effect (49 U. S. C. A., Sec. 316 (g)). In the Federal Communications Act the suspension period is three months (47 U. S. C. A., Sec. 204). In the Interstate Commerce Act the period is 120 days, with power in the commission to extend the period an additional thirty days (49 U. S. C. A., Sec. 15 (7)).

An examination of these statutes reveals that in the Natural Gas Act the commission is vested with no new or extraordinary powers as distinguished from those vested in the regulatory bodies by other statutes enacted by Congress. In every instance Congress has recognized the right of the regulated company to promulgate new rates, but has specifically authorized the regulating body to suspend the new rates for a limited period. In none of these acts

has it vested the regulatory body with any power to suspend the original rates or to establish temporary rates by interim order pending the completion of the hearing. *We have made a careful search and have found no reported case where any of the regulatory commissions created under act of Congress have assumed, under the acts from which they respectively derive their authority, to declare existing rates unjust and unreasonable before a hearing has been finally completed.* The fact that none of the commissions acting under similar statutes has heretofore assumed to exercise any such powers as those assumed by the Commission under the Natural Gas Act is highly significant in that it shows conclusively that none of the commissions has construed the statute as vesting in it any such power or jurisdiction. It must be assumed that Congress had in mind the construction that other commissions, to which it had delegated similar regulatory authority, had placed upon the similar Act at the time it repeated substantially the same langauge in the Natural Gas Act.

In their briefs before the Commission opposing counsel took the position that *Akron C. & Y. Co.* v. *U. S.*, 261 U. S. 184, is authority supporting the power of the Commission to enter an interim order. The Commission in its opinion relies upon this case (R. Vol. VIII, p. 3932). This case is not in point. No issue as to whether or not the existing rates were unjust and unreasonable was involved. The controversy had to do with the just divisions of joint rates, fares, and charges as between railroads operating west of the Hudson and those operating east of the Hudson. The proceeding was not under the section of the Interstate Commerce Act similar to the section of the Natural Gas Act here invoked, but under 49 U. S. C. 15 (6). The evidence was all in. The case had been argued, submitted, and reargued. The court entered an order based upon the whole record, reserving in the order the right to change or modify

it, however, in the event further investigation should determine that its operation worked inequalities among the interested railroads. To issue an order based upon the whole record, after argument and submission by all parties, reserving the right to change or modify the order should inequalities develop as a result of its operation, which was the procedure under review in that case, is one thing; to issue an interim order in the midst of the hearing is an entirely different thing.

That Congress intended no such construction of the statute is evidenced by the proceedings in connection with the enactment of the Natural Gas Act. Cross-petitioners' position is that there is no ambiguity in the language of the Act; that under a fundamental rule of construction the language is controlling, and that it is not proper to consider discussions in Congress, reports of legislative committees, or views of those charged with the administration of the act, for the purpose of ascertaining the intent of Congress. *Commissioner* v. *Adams*, 54 Fed. (2d) 228; *Lansdown* v. *Faris*, 66 Fed. (2d) 939; *U. S.* v. *Hess*, 71 Fed. (2d) 78.

If the statute be viewed as ambiguous (which is untrue in this case), it is proper to determine the construction placed upon the Act by Congress itself, during the debate in connection with its enactment, and by the congressional committee which considered the Act before it was reported out for enactment.

The fact that there was common agreement in debate as to the general purpose of an act may be considered in determining what the purpose was, and as reflecting light upon the evils sought to be remedied. *Federal Trade Commission* v. *Raladam Co.*, 283 U. S. 643, 650; *Humphrey, Exr.* v. *U. S.*, 295 U. S. 602, 625. Discussions of an act when it was under consideration in the House may be consulted to ascertain the meaning of a doubtful proviso.

U. S. v. *Mullendore*, 35 Fed. (2d) 78, 82. Statements of the author of the bill as to its interpretation may be considered by the court in construing an ambiguous act. *U. S.* v. *Rehwald*, 44 Fed. (2d) 663. The rejection of a proposed amendment to a bill will be considered by the courts in construing an act as finally passed if its language is doubtful. *U. S.* v. *U. S. Shoe Machinery Co.*, 264 Fed. 138, 174.

In *Manhattan Properties* v. *Irving Trust Co.*, 291 U. S. 320, 335, the Supreme Court said:

> "In view of the extended consideration and discussion which preceded the passage of the act, the failure to include a provision for claims for loss of rent or for damages consequent on the abrogation of leases is significant of an intent not to depart from the precedents disallowing them."

The Natural Gas Act, as finally enacted, is substantially identical with H. R. 11,662, pending before the 74th Congress at its second session, on which hearings were held by a subcommittee of the Committee on Interstate and Foreign Commerce of the House on April 2, 1936. In substance, if not inexact words, the language on which the Commission relies as authority for the interim order was contained in that bill. The first witness in support of the bill was Mr. DeVane, solicitor of the Federal Power Commission, who appeared for the purpose of explaining the bill. (From this circumstance it may be inferred with reason that the Commission was interested in the enactment of the legislation.) He first pointed out that the bill was substantially the same as that relating to the regulation of the electric industry. We quote from page 29 of the report of that hearing the following dialogue between Mr. DeVane and Mr. Cooper, a member of the Committee:

> "Mr. Cooper: And anyone who wants to file a complaint goes to the Commission; is that right?
>
> "Mr. DeVane: That is correct; and they can

change their rates, Mr. Cooper, by filing new schedules under Section 4(d). After they have filed them with the Commission and announced those new rates, the Commission has the power to suspend and investigate, and the suspending power extends for a period of five months.

"Mr. Cooper: Well, does the Commission have the power to suspend as soon as the protest has been filed?

"Mr. DeVane: Not in the case of protests, Mr. Cooper, no, sir. *The power of suspension only applies to a new rate.*

"Mr. Cooper: What I mean is this, if the gas company establishes a rate and someone files a complaint against that rate with the Commission, does the Commission automatically suspend the rate?

"Mr. DeVane: *It has no authority to suspend that rate.*

"Mr. Cooper: I see. They first have to consider the case.

"Mr. DeVane: That is correct.

"Mr. Cooper: Does it have authority, if it finds that the complaint is well founded?

"Mr. DeVane: If it finds the complaint is well founded, it has authority to prescribe a new rate. That is correct." (Italics ours.)

The following extract from page 45 of the report of the hearing before the subcommittee considering the Natural Gas Act clearly demonstrates that Mr. Booth, of counsel for complainant in this case, who appeared before the subcommittee on March 24, 1937, at that time did not consider that the language he now invokes was sufficient to empower the Commission to enter the order he now seeks to uphold:

"Mr. Booth: First I want to offer for the record a provision which would have the effect of authorizing the Federal Power Commission under any temporary rate situation to fix temporary rates.

"Mr. Bulwinkle: Fix temporary wholesale rates?

"Mr. Booth: Yes, the proposed temporary rate provision would read as follows:

"The Commission may, in any proceeding involving the rates of any natural gas company brought either on its own motion or upon complaint, upon notice and after hearing, if it be of opinion that the public interest so requires, immediately fix, determine, and prescribe temporary rates to be charged by said company pending the final determination of said rate proceeding. Said temporary rates so fixed, determined, and prescribed shall be sufficient to provide a return of not less than 5 per cent upon the original cost, less accrued depreciation, of the physical property of said company used and useful in the gas service, plus a reasonable amount for working capital, and if the duly verified reports of said company to the Commission do not show the original cost, less accrued depreciation, of said property, the Commission may estimate said cost less depreciation and fix, determine, and prescribe rates as hereinbefore provided. In any such proceeding, whenever the annual depreciation expense is computed upon the sinking fund method, no depreciation shall be deducted from such original cost.

"Temporary rates so fixed, determined and prescribed under this section shall be effective until the rates to be charged, received and collected by said company shall finally have been fixed, determined and prescribed. *The Commission is hereby authorized in any proceeding in which temporary rates are fixed, determined and prescribed under this section, to consider the effect of such rates in fixing, determining and prescribing rates to be thereafter charged and collected by said company on final determination of the rate proceeding.*" (Italics ours.)

The following day Chairman Maltbie of the Public Service Commission of New York joined in pressing on the committee the advisability of incorporating a temporary

order provision. We quote from pages 114 and 115 of the report of the hearing before the committee:

"Mr. Maltbie: * * * *Now, there is no provision in here regarding temporary rates.* I think Mr. Booth, of the Illinois Commission, made a suggestion yesterday suggesting that a section copied after the law in the State of New York regarding temporary rates should be added here, and we have found it very advantageous. * * * Now, the New York law permits us to issue a temporary order immediately. If we get the rate too low, below a fair return as the investigation shows, then it is adjusted in the final rate. That has worked satisfactorily and as I say has been upheld by the court of appeals * * *.

"The Chairman: *Does not the fact that you subsequently award the utility the proper amount of compensation in case you under-compensate them in temporary rates save the constitutionality of your method?*

"Mr. Maltbie: *Unquestionably it does. The opinion of the Court of Appeals pointed that out.*" (Italics ours.)

Mr. Booth's solicitude to amend the bill to provide for a temporary rate reduction, which is no different than an interim order reducing rates, may have been due to the holding of the Supreme Court of his own state, Illinois, that in the absence of a statute expressly authorizing it, the Illinois Commerce Commission could not fix a temporary rate. *State Public Utilities Commission* v. *Chicago & W. T. Ry. Co.*, 114 N. E. 325, 329, 275 Ill. 555. In that case the court said:

"There is no provision that the original schedules shall not go into effect pending a hearing thereon before the Commission, but the provisions are expressly to the contrary * * * No authority is given the Commission anywhere in the statute to change the rates named in the original schedules filed except on evidence heard * * *. The Commission was without authority to make such an order except upon a *full* hearing * * *.

"Whether or not the same rates were just and reasonable charges on and after January 1, 1914, is a question to be settled by the Commission after hearing, and until such question is decided by the Commission, *after a full hearing*, it has no jurisdiction or power to order appellants to collect the rates of July 1, 1913, which they insist are confiscatory * * *. Appellants ought not and cannot be legally required to return to such rates or to charge and collect such rates for any period of time before the *question is settled* as to whether or not they are just and reasonable." (Italics ours.)

In passing on the right of the New York Commission to fix temporary rates under the statute in force prior to the enactment of the present statute, the court in *New York* v. *New York Telephone Co.*, 189 N. Y. Sup. 701, 703, said:

"'If the order of March 17th must be regarded as a provisional determination of the "just and reasonable rates, charges, and rentals to be thereafter observed and in force as the maximum to be charged, demanded, exacted or collected for the performance or rendering of the service specified," then the contention of the plaintiff is sound, for the power of the Public Service Commission to make such determination is conferred only by Sec. 97 of the Public Service Commissions Law, and that section gives the Public Service Commission power to determine such rates only after a "hearing," and does not expressly confer upon the Commission any power to make any provisional or conditional determination *pending the completion of the hearing*, nor can any power of such kind be inferred from the general provisions or intent of the act.'"

The only discordant note is found in the decisions of the Oklahoma Supreme Court; but, as pointed out in *Wisconsin Telephone Co.* v. *Public Service Commission*, 287 N. W. 122, 136:

"The cases from the State of Oklahoma cited by the commission are not in point because of the peculiar

constitutional and statutory provisions to be found in the State of Oklahoma. In that state when the court upon appeal reverses an order of the Corporation Commission, the court fixes the proper rate or charge. * * * In addition to that, the decision in *Oklahoma Gas & Electric Co.* v. *Corporation Comm.*, 201 Pac. 505, rests in part for its authority upon *Omaha & C. B. St. Ry. Co.* v. *Nebraska State Railway Comm., supra.* The propositions stated in that case were advanced to sustain an increase in rates whereas in the Oklahoma case the administrative order under consideration provided for a reduction in rates. The fundamental difference in the facts of the two cases seems not to have been observed."

The courts have recognized the difference in a situation presented by an application by a regulated concern for an increased rate, to meet an emergency pending a final hearing on the reasonableness of the rates set up in a new schedule, and that presented by an effort to reduce rates or charges during the course of a hearing over the objection of the regulated concern. *City of Cincinnati* v. *Public Utilities Comm.*, 117 N. E. 381, 96 Ohio St. 270; *Wisconsin Telephone Co.* v. *Public Service Comm.*, 287 N. W. 122. Congress in the Natural Gas Act recognized the distinction (15 U. S. C. 717 c, (d), and (e)). Under these provisions discretion is vested in the Commission to determine whether the new rates shall be suspended pending an investigation. As already pointed out, it wrote into this statute no provision for the suspension or reduction of existing rates pending the completion of the hearing. Had it intended for the Commission to exercise such power, it easily could have expressly so declared by the adoption of one of the amendments offered, which would have conferred express power upon the Commission to enter temporary or interim orders reducing rates.

Some statutes have provided general emergency powers in the commissions to promulgate temporary rates. Such

statutes specifically require that the temporary rates be fixed at an amount that will yield a minimum statutory return on the value of the property reflected by the company records. It is highly significant, however, that the statutes which have been upheld provide that in fixing the final rate the commission shall provide for reimbursing the regulated concern for the difference in the temporary rate and the rate finally fixed if the latter be higher. *Bronx G. & E. Co.* v. *Maltbie*, 3 N. E. (2) 512, 515; *Driscoll* v. *Edison L. & P. Co.*, 307 U. S. 104, 114, 115; *Beaver Valley Water Co.* v. *Driscoll*, 28 Fed. Supp. 722, 725. To meet the decisions of the Illinois Supreme Court, one of which we have cited, the legislature of that state has enacted a statute providing in substance that when the commission finds from an inspection of the property of the utility or its books, records, or papers that the net income is in excess of a reasonable return upon its value, and that a hearing to determine the issues will require more than 120 days, it may enter a temporary order fixing rates to be effective no longer than nine months, with a further extension period of three months at the discretion of the commission. The statute provides, however, that in fixing the permanent rate the commission must make provision for recoupment by the regulated company of any difference between the rates finally determined and those temporarily in force in the meantime. It is necessary only to observe that if the order under review be upheld cross-petitioners will have no such protection, nor could the Commission, in the absence of a statute, make such provision, in the light of the established law that in fixing rates past losses or gains cannot be considered. *Galveston Electric Co.* v. *Galveston*, 258 U. S. 388, 396. The principle that an interim order fixing rates pending the outcome of the rate proceeding cannot be entered in the absence of statutory authority has been recognized by regulatory commissions

as well as the courts. *Berg* v. *N. Y., etc., R. R. Co.*, P. U. R. 1933D, 462 (N. Y.); *Town of Irvington* v. *Commonwealth, etc.*, 10 P. U. R. (N. S.) 329 (N. J.).

Under the Natural Gas Act (15 U. S. C. 717 c(e)) the Commission has power to authorize increased rates or to suspend the operation of proposed increased rates for a limited time without a full hearing. At the end of the limited time, on motion of the regulated company, the increased rates immediately go into effect; but the Act provides that in such event the Commission may require the natural gas company to furnish a bond to refund any amounts ordered by the Commission not found to be justified at the conclusion of the hearing. If Congress had intended to empower the Commission to suspend an existing rate under investigation, would it not have taken the same pains expressly to outline the procedure and to provide for the recoupment by the natural gas company of the difference in the temporary or interim rate set up and that finally established? *Failure of Congress to incorporate provisions similar to those contained in the New York, Pennsylvania, and Illinois statutes, particularly in view of the amendments offered by Mr. Booth, of the Illinois Commission, and Mr. Maltbie, of the New York Commission, is highly significant and cannot be disregarded.* The New York amendment authorizing temporary orders on the basis finally upheld was enacted in 1934, the Pennsylvania act was passed in 1937, and the Illinois amendment was passed in 1933. These acts having been passed, and construed in the case of the New York statute, the failure of Congress to incorporate amendments authorizing temporary or interim rates conclusively establishes, we submit, that Congress did not intend to vest in the Federal Power Commission the authority to enter any such order as that here under review.

That the Commission had no authority to enter a rate regulatory order at the stage of the proceedings which

has been reached is emphasized and demonstrated further by the complete lack of any evidence in the record upon which the Commission can determine reasonable rates. In a preceding section of this brief it has been shown that the Commission's order is merely an order reducing profits and does not fix rates on evidence as prescribed by statute. The so-called interim order entered in the midst of proceedings and before a record had been completed, which compliance with the statute required, is clearly invalid.

VIII.

The Court Below Erred in Not Sustaining Cross-Petitioners' Contention That the Commission's Order Should Be Set Aside Because the Natural Gas Act as Applied by the Commission to Cross-Petitioners' Business Is in Conflict With the Fifth Amendment to the Constitution of the United States.

A. *The Regulation Imposed Is Violative of the Fifth Amendment Because Cross-Petitioners' Business Is Not Affected With a Public Interest and Is Not Subject to a Price Regulation.*

(Sec. 9, Summary of Argument, *supra*, p. 65.)

This case squarely presents the question of whether Congress may, under the Fifth Amendment, fix prices on private sales of an ordinary commodity. The question is that broad. There are here no peculiar limiting factual circumstances. In every case in which this Court has upheld price fixing under the Fifth Amendment there have existed peculiar factual circumstances which are lacking here and which justified the legislative control. This Court has refused consistently and repeatedly to hold that a legislative body may, under the Fifth and Fourteenth Amendments, fix prices on private sales on an ordinary commodity. The decision of the Court below in upholding

the price fixing here involved goes beyond any decision by this Court and beyond, cross-petitioners submit, the limitations of the Fifth Amendment on the powers of Congress under the Commerce Clause of the Constitution. The undisputed facts are:

1. Cross-petitioners' sales are sales of an ordinary commodity to a few selected buyers;
2. Cross-petitioners are not a common carrier;
3. They have not constituted themselves a public utility or dedicated their property to the public use by offering to sell their commodity to all who apply; and
4. The industry in which they are engaged is not one in which the "free competition had been 'degraded into anarchy'" (*Sunshine Anthracite Coal Co.* v. *Adkins*, 310 U. S. 381, 395).

We shall first discuss the factual situation here; second, the cases which this and other courts have decided with respect to price fixing under the Fifth and Fourteenth Amendments; and, third, the decision of the Court below on this issue.

Cross-petitioners' business is of a strictly private character. Cross-petitioners have never held themselves out to the public as common carriers; nor have cross-petitioners offered to sell their gas to the general public (R. Vol. I, p. 11). Ninety per cent of the gas transported by their pipeline is sold to Chicago District Pipeline Company for resale by the latter to the distributing utilities operating in the City of Chicago and environs, which in turn blend such natural gas with manufactured gas and distribute the resulting commodity to the ultimate consumer (R. Vol. VIII, p. 3943). Of the remaining 10%, about 8% is sold to other utilities along or near cross-petitioners' pipeline and about 2% is sold by cross-petitioners directly to industrial users (Exhibit 9, R. Vol. V, p. 2681; Vol. I, p. 57). Cross-petitioners have at all times sold their gas by private contracts negotiated at great expense to cross-

petitioners, the negotiations sometimes extending over two or three years (R. Vol. II, p. 681). Since the commencement of their operations cross-petitioners have made a total of 161 contracts (R. Vol. II, p. 685). Of these contracts 47 are still in effect (R. Vol. II, p. 685). Under these 47 contracts cross-petitioners have 12 customers (Exhibit 11, R. Vol. V, p. 2685; Vol. I, p. 57). Cross-petitioners do not operate under any franchise; they have no monopoly. Cross-petitioners embarked upon and have maintained a private business with complete freedom and control of their contracts of sale. They are a private purveyor of a commodity.

By the enactment of the Natural Gas Act Congress undertook by legislative fiat to change completely the character of cross-petitioners' business and the use of cross-petitioners' facilities. The Act declares that cross-petitioners' business is affected with a public interest and that Federal regulation is necessary in the public interest (Section 1a). It declares all rates and charges for the sale of natural gas subject to the jurisdiction of the Commission (Section 4). Cross-petitioners' charges are, under the Act, subject to investigation by the Commission on complaint or on its own motion (Section 5a). If the Commission has a hearing and finds that cross-petitioners' charges are unjust or unreasonable, the Commission is directed to determine just and reasonable charges and to fix the same by order (Section 5a). The Commission may by order direct cross-petitioners to extend or improve their transportation facilities and to establish physical connection with the facilities of, and sell natural gas to, any person or municipality engaged, or authorized to engage, in the local distribution of natural or artificial gas to the public (Section 7a). Cross-petitioners cannot abandon all or any portion of their facilities, or any service rendered by means of such facilities, without permission

or approval of the Commission (Section 7b). Cross-petitioners are subject to severe penalties or imprisonment and substantial fines if they fail or refuse to comply with the Commission's orders relating to their services or charges (Section 21). Thus, by the terms of the Act Congress attempts to transform cross-petitioners' business of producing, purchasing, and selling a commodity into a business as completely subjected to public regulation as that of a utility which voluntarily dedicates its property to the public use and holds itself out to serve all who may apply for service.

The Fifth Amendment imposes the same restriction upon the powers of Congress under the Commerce Clause as does the Fourteenth Amendment on a State legislature in the exercise of the State's police power (*U. S.* v. *Rock Royal Cooperative, Inc.*, 307 U. S. 533, 569-571).

This Court has consistently held that a state legislature has no power to convert by fiat a private business into a public utility. In *Michigan Public Utilities Commission* v. *Duke*, 266 U. S. 570, 577-8, this Court had under consideration a Michigan statute providing for the regulation as common carriers of any persons engaged in automotive transportation for hire. The plaintiff was engaged in transporting automobile bodies from Detroit, Michigan, to Toledo, Ohio, under three private contracts. He did not hold himself out to the public as a carrier. He engaged in no transportation business other than in pursuance of the three private contracts. In holding the Act unconstitutional, this Court said:

> "It is beyond the power of the state by legislative fiat to convert property used exclusively in the business of a private carrier into a public utility, or to make the owner a public carrier, for that would be taking private property for public use without just compensation, which no state can do consistently with the due process clause of the Fourteenth Amendment."

> • • • On the facts above referred to, it is clear that, if enforced against him, the act would deprive plaintiff of his property, in violation of that clause of the Constitution."

Cross-petitioners are in a stronger position on the facts than was the plaintiff in the case just cited. They are not transporting gas for hire under private contracts. They are transporting their own gas from their wells, and from the point where they purchase gas from a single producer under private contract, to points where they deliver gas at wholesale to those who distribute it to the general public. Cross-petitioners' position is more analogous to that of a farmer who buys a truck and uses it to transport his wheat, his corn, his potatoes, or his hogs to the local market, or of an oil company owning wells in one locality and a refinery at some distance away, which builds and operates a pipeline for the purpose of transporting its own oil from its own wells to its refinery, to be there processed and sold to selected buyers.

To the same effect as the *Duke* case are *U. S.* v. *Ohio Oil Co.*, 234 U. S. 548, 562-3 (Uncle Sam oil company angle), and *Producers Transportation Co.* v. *Railroad Commission*, 251 U. S. 228, 230-231.

In every case in which the issue as to price fixing is as broad as that presented here, this Court has struck down the statute. In *Williams* v. *Standard Oil Co.*, 278 U. S. 235, 239-40, this Court held invalid a Tennessee statute fixing prices at which gasoline might be sold within the State. This Court said:

> "It is settled by recent decisions of this court that a state legislature is without constitutional power to fix prices at which commodities may be sold, services rendered, or property used, unless the business or property involved is 'affected with a public interest.' *Chas. Wolff Packing Co.* v. *Court of Industrial Relations*, 262 U. S. 522, 67 L. Ed. 1103 • • •; *Tyson &*

Bro. United Theatre Ticket Offices v. *Banton, supra; Fairmont Creamery Co.* v. *Minnesota,* 274 U. S. 1, 71 L. Ed. 893 * * *; *Ribnik* v. *McBride,* 277 U. S. 350, 72 L. Ed. 913. * * * Nothing is gained by reiterating the statement that the phrase is indefinite. By repeated decisions of this court, beginning with *Munn* v. *Illinois,* 94 U. S. 113, 24 L. Ed. 77, that phrase, however it may be characterized, has become the established test by which the legislative power to fix prices of commodities, use of property, or services must be measured. As applied in particular instances, its meaning may be considered both from an affirmative and a negative point of view. Affirmatively, it means that a business or property, in order to be affected with a public interest, must be such or be so employed as to justify the conclusion that it has been *devoted* to a public use and its use thereby in effect *granted* to the public. * * * Negatively, it does not mean that a business is affected with a public interest merely because it is large or because the public are warranted in having a feeling of concern in respect of its maintenance. * * *

"In support of the act under review it is urged that gasoline is of widespread use; that enormous quantities of it are sold in the state of Tennessee; and that it has become necessary and indispensable in carrying on commercial and other activities within the state. But we are here concerned with the character of the business, not with its size or the extent to which the commodity is used. Gasoline is one of the ordinary commodities of trade, differing, so far as the question here is affected, in no essential respect from a great variety of other articles commonly bought and sold by merchants and private dealers in the country. The decisions referred to above make it perfectly clear that the business of dealing in such articles, irrespective of its extent, does not come within the phrase 'affected with a public interest'."

In *New State Ice Co.* v. *Liebmann,* 285 U. S. 262, 277, this Court struck down an Oklahoma statute prohibiting the manufacture, sale, and distribution of ice without a State

license. In *Tyson* v. *Banton*, 273 U. S. 418, 431, this Court struck down a statute fixing resale prices of theater tickets, holding that the mere fact that a business is affected with a public interest, in the sense that police regulations may be imposed, does not mean that the interest is such as to justify price regulation.

In *Wolff* v. *Court of Industrial Relations*, 262 U. S. 522, 537, this Court said:

> "It has never been supposed, since the adoption of the Constitution, that the business of the butcher, or the baker, the tailor, the wood chopper, the mining operator, or the miner was clothed with such a public interest that the price of his product or his wages could be fixed by state regulation."

The business of cross-petitioner Texoma Natural Gas Company was expressly held not to be affected with a public interest in *Texoma Natural Gas Co.* v. *Railroad Commission*, 59 Fed. (2d) 750, 754 (D. C., Texas, C. J. Hutcheson, *D. JJ.* West and Bryant). The Court said:

> "The business of dealing in gasoline is held not to be affected with a public interest, so that a state legislature is powerless to fix prices at which it may be sold. *Williams* v. *Standard Oil Co.*, 278 U. S. 239, * * * 73 L. Ed. 287, * * * The gas under question here is not affected with a public interest. * * *"

In each case in which this Court has upheld price fixing there have been peculiar circumstances warranting the legislation. This Court has held that price regulation is justified in only two factual situations:

> 1. Where the concern itself has devoted its business to a public use by holding itself out to serve all who may apply.

Munn v. *Illinois*, 94 U. S. 113 (grain elevator) is an example in the State domain and *Stafford* v. *Wallace*, 258 U. S. 495 (Stock Yards Commission houses) is an example in the Federal domain. In *Munn* v. *Illinois*, this Court

upheld a statute providing for the fixing of charges for the storage of grain in elevators in Chicago, the country's principal grain market. The record showed that the elevators handled the grain from all over the country and that they held themselves out to render the service of storing and handling the grain for any who might apply. The Court held that the service performed by these elevators was strictly analogous to that performed by common carriers. In *Stafford* v. *Wallace*, the same situation obtained with respect to the Stock Yards Commission houses; they held themselves out to serve all who applied and were in the position of common carriers in performing a service at the Stock Yards of Chicago. *Townsend* v. *Yeomans*, 301 U. S. 441, is another similar case. There the Court upheld the fixing of charges for storing tobacco in public warehouses which held themselves out to serve all who applied.

2. The second factual situation which this Court has held justifies price regulation is where chaotic economic conditions, price wars, etc., have caused free competition to be degraded into anarchy.

In *Sunshine Anthracite Coal Co.* v. *Adkins*, 310 U. S. 381, 395, the right of Congress to regulate prices of coal was upheld, not on the broad theory that the coal as a commodity is subject to price regulation, but on the ground that Congress had power to deal with the peculiar conditions obtaining in the coal industry which had become chaotic. The statute under consideration there did not in fact provide for complete price regulation, such as does the statute here, but provided for only minimum and maximum prices. The question before the Court was much narrower than the issue presented here. In *Nebbia* v. *New York*, 291 U. S. 502, 530, the New York statute providing for the regulation of milk prices was upheld on the same ground, to-wit, the legislature had power to deal with the evils and maladjustments existing in the milk business. The Court emphasized the destructive and demoralizing

conditions in the industry and unfair trade practices which resulted in retail price cutting, and which reduced the income of the farmer below the cost of production. The decision was not based upon a holding that a legislative body may at will fix prices on the private sales of a commodity such as milk. The statute in that case, like the statute in the *Sunshine* case, provided only for minimum and maximum prices. In *United States* v. *Rock Royal Cooperative, Inc.*, 307 U. S. 533, 567-571, the Federal statute respecting milk regulation was sustained upon the same ground. In that case the statute provided for only minimum prices. The legislation was directed at and limited to alleviation of chaotic economic conditions. In each of the foregoing three cases, there was no effort on the part of the legislative body to convert the coal and milk businesses into public utilities. The effort in the case at bar is definitely to convert cross-petitioners into public utilities. The decisions of this Court in the *Sunshine, Nebbia,* and *Rock Royal* cases are not authority for the action taken by Congress. This case falls squarely within the holding of this Court in *Williams* v. *Standard Oil Co.*, 278 U. S. 235 (gasoline), *New State Ice Co.* v. *Liebmann*, 285 U. S. 262 (ice), and similar cases where this Court has rejected the broad contention that prices on the private sale of a commodity may be fixed. The case of *Olsen* v. *Nebraska*, 85 L. Ed. 820, is not authority for price fixing on sales of a commodity. The legislation there under consideration limited the maximum charges of employment agencies and was directed against frauds and unscrupulous dealings.

The Court below (R. Vol. VIII, p. 4030) conceded the force of the factual distinctions between the instant case and the *Nebbia* and *Sunshine* cases, but concluded nevertheless that the instant legislation was within the broad powers of Congress. We shall later discuss specifically the reasoning of the Court below, but first we shall point out

that there are in this case no limiting factual circumstances justifying price regulation.

It has been pointed out that the cross-petitioners' business is not beset with economic difficulties and economic chaos. On the contrary, complainant and the Commission contend that cross-petitioners are too prosperous.

The fact that natural gas is a natural resource does not justify governmental price regulation. Numerous ordinary commodities are natural resources: gasoline, oil, salt, lumber, iron ore, tobacco are a few of numerous ordinary commodities which are natural resources or are derived from the soil. A party with the enterprise and initiative to mine or to produce or to raise these commodities and to market them is no more in a public business than a party processing or manufacturing and selling any article of wide use. This Court has never gone so far as to hold that the Commerce Clause or the State police power permits the fixing of prices on private sales of ordinary commodities whether they be products which are natural resources or not. The fact that the supply of natural gas in the field in which cross-petitioners' supply is located will some day be exhausted does not justify price regulation. Oil fields, salt mines, and iron ore mines will some day be exhausted. Cross-petitioners' business is no more a public business than that of the owner of a forest who erects his own saw mill and, by means of his own trucks or barges, transports his own lumber to selected dealers. Cross-petitioners might also be compared to a mine owner transporting his own coal by his own ships to Chicago for sale to retail coal dealers or to a public utility for use in the manufacture of artificial gas.

The fact that cross-petitioners sell natural gas to utilities which distribute the gas to the public does not justify price fixing. It is true that such utilities whose prices are subject to regulation must have natural gas. If such a utility

does not own its own reserves, it must purchase this natural gas at wholesale from someone situated as are cross-petitioners, or from someone who owns or buys natural gas and pays to have it transported to the utilities' field of operation. But such a distributing utility cannot operate its business by purchasing natural gas alone. It must have offices, for which it must purchase furniture, mechanical equipment, stationery, ink, and pencils. It must purchase hammers, wrenches, waste, lubricants, bolts, nuts, and a thousand other items. It must purchase meters, compressors, valves, steel pipe, and other heavy equipment. Indeed, a very large proportion of the total costs which enter into the ultimate price charged by utilities to their consumers is represented by the fixed charges on their capital facilities and the operating expenses incident to the transportation and the service connected with the conduct of their business. In other words, much of the cost to the domestic or other consumer is represented by the charges made for facilities and for service. Often the domestic customer uses but a small quantity of natural gas during the month for which his bill is rendered by the utility. The charges for such services are subject to regulation, but on the ground, not that a great many people utilize those services, but that the utility holds itself out, with certain conditions, to serve all who apply and meet the conditions. There is no more reason for holding, because the business of the public utility which purchases natural gas at wholesale is affected with a public interest in the sense that its charges to the public are subject to regulation, that the government or the state can fix the price at which it purchases the commodity at wholesale than for holding that the government or the state has the right to fix the price at which the distributing utility purchases its steel pipe, its pumps, its engines, its meters, and the thousand other articles which go to make up its facilities.

Cross-petitioners' business is comparable to that of an

electric power company manufacturing electric current and selling it at wholesale by private contract to utilities, which in turn distribute electricity to the public. Such an electric power company was held not to be a public utility in *Union Falls Power Co.* v. *City.* 265 N. W. 722, 723 (Wis. Sup. Ct.), in which case the Supreme Court of Wisconsin had under consideration a statute providing for a special tax levy applied to utilities. In holding that a wholesale electric power company was not entitled to invoke the benefits of this tax statute as a utility, the Court said:

> "'It was not the furnishing of heat, light or power to tenants or incidentally to a few neighbors that the legislature sought to regulate, but the furnishing of those commodities to the public, that is, to whoever might require the same. * * * The use to which the plant, equipment or some portion thereof is put must be for the public, in order to constitute it a public utility.' * * * The fact is that plaintiff does not hold itself out as being able, ready and willing to serve the public. In this case * * * the plaintiff * * * does not deal with the public directly or indirectly. It deals with a utility which in turn deals with the public. * * * We conclude that the plaintiff company is not a public utility and, therefore, it was properly assessable in accordance with applicable laws of the state and not assessable as a public utility."

Most of those who purchase gas from cross-petitioners blend the commodity with artificial gas manufactured at their own plants or purchased from others. This artificial gas is an essential constituent of the blended product sold to the public. What reasoning could justify the imposing of government regulation upon the price paid for natural gas, one of the constituents entering into the blended commodity, and at the same time leaving entirely unregulated the price paid for, or representing the cost of manufacturing, artificial gas, the other constituent?

If the fact that cross-petitioners' gas is blended with artificial gas, or sold as natural gas, by utilities, whose

prices to the ultimate consumer are subject to regulation, be used as a ground for the construction of the commerce clause permitting regulation of cross-petitioners' prices, where, under such a construction, would price regulation stop? If the Government can fix the cost of natural gas, it can just as logically fix the cost of the artificial gas which these utilities purchase, or the cost of the buildings, boilers, engines, and other machinery and equipment which they utilize in the manufacture of artificial gas, if they make it for themselves.

Likewise, if on that theory the prices at which cross-petitioners sell natural gas are subject to regulation, the prices of those things which cross-petitioners must purchase in order to engage in the business of producing, transporting, and selling natural gas are subject to regulation. The Government could regulate the contract price for the drilling of wells, the price of the casing that goes into the wells, the price of the lumber which goes into the derrick above the well, and the price of the nails and bolts which hold this lumber together as a derrick, the price of the pipe, the meters and regulators out in the field, the field compressor stations, the main pipeline facilities, including compressor units, engines, housing facilities, bridges, gasoline plant facilities, the dehydrating plant facilities, and the thousand other things which cross-petitioners have purchased, and the cost of putting all these physical elements together to constitute their production and transportation facilities. Likewise, the Government could regulate the salaries of the six or seven hundred men who are employed by cross-petitioners in this connection. If such prices can be regulated, the prices of everything that enters into the acquiring and cutting of timber and sawing it into lumber, or acquiring and mining iron and processing it into steel—indeed, the cost clear back to the source of every element which enters into the facilities of cross-petitioners devoted to their business of producing, purchas-

ing, transporting and selling natural gas—can be regulated.

The declaration of Congress in the Natural Gas Act that cross-petitioners' business is affected with a public interest is not binding upon cross-petitioners. The declaration of Congress is (Section 1):

> "As disclosed in reports of the Federal Trade Commission made pursuant to S. Res. 83 (70th Congress, First Session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest."

Such declaration is binding neither on this Court nor on cross-petitioners (*Wolff Packing Co.* v. *Court*, 262 U. S. 522, 536; *Tyson Bros.* v. *Banton*, 273 U. S. 418, 431). The facts respecting cross-petitioners' business refute the attempt by Congress to place cross-petitioners' business in a special category. The effort of Congress here is nothing more than an attempt to regulate the price at private sale of an ordinary commodity.

The Court below (R. Vol. VIII, pp. 4030-4031), after conceding the factual distinction between the case at bar and the *Nebbia*, *Sunshine*, and *Appalachian*[1] cases, stated:

> "Where a legislative determination is based upon a very extended administrative investigation, which concluded that an industry was affected with a public interest and that Federal regulation thereof was necessary and that said business or industry is producing and transporting natural gas to be sold to gas companies engaged in public utility business in cities and villages, there exists no basis for a successful attack on such determination."

1. *U. S.* v. *Appalachian Electric Power Co.*, 85 L. Ed. 201.

This statement is in part directly contrary to the decisions of this Court in *Williams* v. *Standard Oil Co.*, 278 U. S. 235; *New State Ice Co.* v. *Liebmann*, 285 U. S. 262, and similar cases. In those cases this Court held that there did exist a basis for a "successful attack" in spite of the legislative determination that regulation of the gasoline and the ice businesses was in the public interest. The statement of the Court below is based in part upon the fallacious proposition that cross-petitioners are subject to regulation because they sell to distributing public utilities. The Court below next said:

> "The natural gas industry controls the source of a commodity of great public importance and widespread consumption and therefore its regulation by Congress may well be required."

This illustrates the sweeping character of the decision below. The same statement and reasoning justify price regulation of iron ore, salt, oil, gasoline, clothing, food, lumber, brick, etc. The Court continues:

> "At least, Congress, in its wisdom, may so conclude. Courts cannot and should not assume a greater wisdom than Congress, and find otherwise."

It is submitted that the Fifth Amendment prohibits Congress from concluding in its wisdom that the price of meat on a private sale can be fixed, special circumstances such as chaotic economic conditions being absent. Cross-petitioners recognize the rule often reiterated by this Court that where Congress acts within its authority the wisdom of legislation is for Congress and not for the courts; but cross-petitioners insist that in this case the legislation is beyond the authority of Congress under the Constitution.

Despite the concession by the Court below that the facts in the *Sunshine* and *Nebbia* cases are different from the facts at bar, the Court quoted extensively from the opinions in those cases (R. Vol. VIII, pp. 4030, footnote 7).

Cross-petitioners do not ask this Court to retract anything there said. In the *Nebbia* case, 291 U. S. 502, 536, this Court said as to the test in determining validity of price fixing:

> "It is clear that there is no class or category of businesses affected with public interest, and the function of courts in the application of the Fifth and Fourteenth Amendments is to determine in each case whether *circumstances* vindicate the challenged regulation as a reasonable assertion of governmental authority or condemn it as arbitrary and discriminatory."

Cross-petitioners submit that the regulation in this case is arbitrary and discriminatory. The *circumstances* here show that the regulation is arbitrary and discriminatory. Cross-petitioners are in no different position from the ordinary purveyor of an ordinary commodity. The upholding of the Natural Gas Act as applied to these cross-petitioners necessitates a construction of the commerce clause which would permit of the price regulation and control of all American industry engaged in interstate commerce and all American commodities sold in interstate commerce.

B. *The Regulation Imposed Is Violative of the Fifth Amendment Because It Involves a Taking of the Use of Cross-Petitioners' Property for the Public and Prohibits Cross-Petitioners From Withdrawing Their Property From Such Use Except by Permission of the Commission.*

The Natural Gas Act not only subjects to regulation the prices charged by cross-petitioners to those with whom they have made private contracts, but it purports to delegate to the Federal Power Commission the right to select the purchasers for cross-petitioners to and require cross-petitioners to extend their facilities and to serve such purchasers (Section 7, 15 U. S. C. 717 f). Cross-petition-

ers organized their business on the assumption that they would be permitted to select their purchasers, to pass upon their credit, to pass upon the feasibility of extending their lines to serve such purchasers, and to pass upon the risks involved in view of the volume of gas which the purchasers would be in position to utilize. Cross-petitioners assumed that if it proved to be unprofitable to serve a particular customer they could discontinue the service at the end of their contractual obligation. But not so now, if the Natural Gas Act is valid. Under the operation of the Act, cross-petitioners must not only limit their charges to those fixed by the Federal Power Commission, but they must serve all whom the Federal Power Commission directs them to serve within their reach. They cannot discontinue the service to those whom they are now serving, regardless of whether they deem the services to be profitable or otherwise; nor can they discontinue the service to those to whom the Commission shall require them to extend their services, without first obtaining the permission of the Commission to do so.

Cross-petitioners' gas used in domestic consumption commands the highest price. That used in commercial consumption represents a higher price than that used for industrial purposes or for boiler fuel. Cross-petitioners' contracts for industrial sales have been negotiated on an interruptible basis, the obvious purpose of which was to permit them to discontinue this service at any time they may find a more profitable outlet for uses that would command higher prices. But under the Natural Gas Act they cannot discontinue the service to any now being served without permission of the Commission. It is obvious that the whole character of cross-petitioners' business is changed under the operation of the Natural Gas Act, if valid. This change in the character of cross-petitioners' business renders price regulation under the Natural Gas Act invalid because in conflict with the Fifth Amendment.

This question was discussed by this Court in *Chas. Wolff Packing Co.* v. *Court of Industrial Relations,* 262 U. S. 522, 534, 539. The Court had before it a state statute providing for the fixing of wages in a meat-packing plant. Under the Statute the employer was required to pay the fixed wages and the employees were prohibited from striking against the fixed wages. The Court held that it was not necessary to decide whether or not the meat-packing business is affected with a public interest since, under the Act, *the business was required to proceed on the wages fixed.* In effect the Court held that even if the packing business be affected with a public interest, the imposition of fixed wages from which the business could not withdraw was invalid regulation under the Fourteenth Amendment. The Court said (p. 534):

> "Under the construction adopted by the state supreme court the act gives the industrial court authority to permit the owner or employer to go out of business, if he shows that he can only continue on the terms fixed at such heavy loss that collapse will follow; but this privilege, under the circumstances, is generally illusory. *Block* v. *Hirsh,* 256 U. S. 135, 157, 65 L. Ed. 865, 871. A laborer dissatisfied with his wages is permitted to quit, but he may not agree with his fellows to quit, or combine with others to induce them to quit."

It is true cross-petitioners may quit business or discontinue service if the Commission, on the facts presented, sees fit to permit them to do so; but this privilege in the case at bar is just as "illusory" as in the *Wolff* case or the *Block* case.

Continuing, the Court said (pp. 539-44):

> "If, as, in effect, contended by counsel for the state, the common callings are clothed with a public interest by a mere legislative declaration, which necessarily authorizes full and comprehensive regulation within legislative discretion, there must be a revolution in the relation of government to general business. This

will be running the public interest argument into the ground, to use a phrase of Mr. Justice Bradley when characterizing a similarly extreme contention. *Civil Rights Cases*, 109 U. S. 3, 24, 27 L. Ed. 835, 843, 3 Sup. Ct. Rep. 18. It will be impossible to reconcile such result with the freedom of contract and of labor secured by the 14th Amendment.

"This brings us to the nature and purpose of the regulation under the Industrial Court Act. The avowed object is continuity of food, clothing, and fuel supply. By Sec. 6 reasonable continuity and efficiency of the industries specified are declared to be necessary for the public peace, health, and general welfare, and all are forbidden to hinder, limit, or suspend them. Section 7 gives the industrial court power, in case of controversy between employers and workers which may endanger the continuity or efficiency of service, to bring the employer and employees before it, and, after hearing and investigation, to fix the terms and conditions between them. The employer is bound by this act to pay the wages fixed; and while the worker is not required to work at the wages fixed, he is forbidden on penalty of fine or imprisonment, to strike against them, and thus is compelled to give up that means of putting himself on an equality with his employer which action in concert with his fellows gives him.

"There is no authority of this court to sustain such exercise of power in respect to those kinds of business affected with a public interest by a change in pais, first fully recognized by this court in *Munn* v. *Illinois*, 94 U. S. 113, 24 L. Ed. 77, where it said (p. 126):

> 'Property does become clothed with a public interest when used in a manner to make it of public consequence and affect the community at large. When, therefore, one devotes his property to a use in which the public has an interest, he in effect grants to the public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created. *He may withdraw*

his grant by discontinuing the use; but so long as he maintains the use, he must submit to the control.' (Italics are the Court's).

* * * * *

"But the chief and conclusive distinction between *Wilson* v. *New* (243 U. S. 332, 61 L. Ed. 755, L. R. A. 1917E, 938, 37 Sup. Ct. Rep. 298, Ann. Cas. 1918A, 1024) and the case before us is that already referred to. The power of a legislature to compel continuity in a business can only arise where the obligation of continued service by the owner and its employees is direct, and is assumed when the business is entered upon. A common carrier which accepts a railroad franchise is not free to withdraw the use of that which it has granted to the public. It is true that, if operation is impossible without continuous loss (*Brooks-Scanlon Co.* v. *Railroad Commission*, 251 U. S. 396, 64 L. Ed. 323, P. U. R. 1920C, 579, 40 Sup. Ct. Rep. 183; *Bullock* v. *Florida*, 254 U. S. 513, 65 L. Ed. 380, P. U. R. 1921B, 507, 41 Sup. Ct. Rep. 193), it may give up its franchise and enterprise; but, short of this, it must continue. Not so the owner when, by mere changed conditions, his business becomes clothed with a public interest. He may stop at will, whether the business be losing or profitable.

* * * * *

"We think the Industrial Court Act, in so far as it permits the fixing of wages in plaintiff in error's packing house, is in conflict with the 14th Amendment, and deprives it of its property and liberty of contract without due process of law."

From this opinion and the cases therein cited, it is plain that whether a business is affected with a public interest is a *question of fact* to be determined under the circumstances at the time and place. The legislature makes the determination in the first instance. If the legislature decrees that a business is public, the way must be left open for the owner to withdraw. The owner did not invest his money in a public business. The legislature cannot *compel*

him to do so. Here the door is not left open. Cross-petitioners are required to proceed.

If it be thought that this issue is not involved in this case because cross-petitioners have not attempted to withdraw their property from the public use, attention is called to two points: (1) the employer in the *Wolff* case had not attempted to withdraw; and (2) in the case at bar, Section 21 of the Natural Gas Act (15 U. S. C. 717 t) imposes a fine or imprisonment, or both, upon any party who wilfully and knowingly violates the Act.

IX.

The Court Below Correctly Held, in Effect, That the Holding of the Commission That $6,395,180 Per Annum Is an Adequate Allowance to Cross-Petitioners for Amortization and Return Is Not Supported by Substantial Evidence and Is Contrary to the Law Applicable to Such Allowances.

X.

The Court Below Correctly Held, in Effect, That the Holding and Finding of the Commission that Cross-Petitioners' Annual Net Revenues Available for Amortization and Return Exceed the Amount Reasonably Necessary by $2,966,852, and That a Reduction in Cross-Petitioners' Annual Revenues of the Amount Last Stated, Together With the Consequent Reduction in the Applicable Federal Income Taxes, Would Permit a Reduction in Net Operating Revenues of $3,750,000 Annually, Are Not Supported by Substantial Evidence and Are Contrary to the Law Applicable to the Fixing of Proper Allowances for Cross-Petitioners.

XI.

The Court Below Correctly Held, in Effect, That the Holding of the Commission That the Rates and Charges of Cross-Petitioners, After Reflecting the Reduction Ordered, Will Be Just and Reasonable Is Not Supported by Substantial Evidence.

XII.

The Commission's Order, as Modified, Directing Cross-Petitioners, on or Before September 1, 1940, to File New Schedules of Rates and Charges for the Sale of Gas Which Shall Reflect a Reduction in Cross-Petitioners' Operating Revenues of Not Less Than $3,750,000 Per Annum, If Enforced, Would Result in Confiscation of Cross-Petitioners' Property and Revenues, in Violation of the Due Process Clause of the Fifth Amendment to the Constitution of the United States.

The last four propositions are of summary character and embody the various errors submitted and briefed in connection with the preceding propositions of law, and the subdivisions of such propositions. It is not necessary, therefore, to elaborate on the errors stated in the last four propositions, or to cite authorities in support thereof; for it follows, of course, that if the assignments of error raised in the preceding propositions, or any of them, be sustained by the Court, the assignments presented in the last four propositions will be sustained.

Summary.

A. *Going Concern Value* (pp. 68-101, *supra*).

The court below correctly held that the Commission erred as a matter of law in not allowing the claim of $8,500,000 as going concern value. The refusal of the Commission to include that value in the amount to be amortized manifestly

would result in the *confiscation of cross-petitioners' property to that amount.* The refusal of the Commission to include that value in the rate base manifestly would result in the *confiscation of the reasonable return on that value* to which cross-petitioners are entitled. At 6½% per annum, the rate of return allowed, the amount thus confiscated *each year* would be $552,500. At 8% per annum, the rate of return to which cross-petitioners believe themselves entitled under the evidence, the amount thus confiscated each year would be $680,000.

B. *Amortization.*

(1) The Period of Amortization (pp. 102-129, *supra*).

The court below correctly held that the Commission erred as a matter of law in fixing the amortization period at 23 years, beginning January 1, 1932, the date cross-petitioners commenced operations as a private enterprise. Assuming no error by the Commission in using an interest rate of 6½% compounded annually in computing the annual allowance for amortization, and assuming that the period should have been 16 years 6⅓ months, beginning with June 21, 1938, the date the Natural Gas Act became effective, the error of the Commission on this point would result in the confiscation of $40,394,505 over the remaining life of cross-petitioners' enterprise (see p. 129, *supra*). On each of the two assumptions the amount confiscated would, of course, include the amount confiscated by failure to include the going concern value in the amount to be amortized.

(2) The Interest Rate in Computing the Annual Amount (pp. 130-144, *supra*).

Under the uncontradicted evidence the Commission should have used 2% compounded semi-annually as the interest rate in computing the annual allowance for amortization

by the sinking fund method. In using the rate of return allowed, 6½% per annum compounded annually, as the interest rate in computing the annual allowance for amortization, the Commission erred as a matter of law. Assuming for the purpose of this question no error in fixing the period of amortization at 23 years, the error of the Commission on this point manifestly would result in the confiscation of $39,352,707 (see p. 144, *supra*).

(3) The Combined Result of the Errors in Fixing the Annual Allowance for Amortization.

In dealing with the subject of amortization the Commission erred as a matter of law in three particulars: first, in fixing the amount to be amortized, second, in fixing the period of amortization, and, third, in using a 6½% interest rate. It is necessary, therefore, to test the result of the order, giving effect to all three of these errors.

Should the Court find that the proper period of amortization is 16 years 6⅓ months, beginning with June 21, 1938, the date on which the Natural Gas Act became effective, it develops that $1,557,852, the annual allowance fixed by the Commission, together with interest on each installment at the rate of 2% per annum compounded semi-annually, would accrue a total of $30,189,843 by the end of 1954. Thus it appears that of $84,341,218, to which the court below held cross-petitioners to be entitled, there would be a deficit of $54,151,375, which amount would be confiscated over the period on account of these errors. The proper amount to be set aside each year in order to accumulate the total of $84,341,218 over the 16 years 6⅓ months is $4,330,818. *Thus as a result of these errors there is a confiscation each year of* $2,772,966, the difference between the correct amount and $1,557,852 actually allowed.

Should the Court find that the amortization period should begin on August 1, 1940, the date of the order, the period of amortization ending with the year 1954 would be 14

years 5 months. It develops that $1,557,852, the annual allowance fixed by the Commission, together with interest on each installment at the rate of 2% per annum compounded semi-annually, would accrue a total of $25,741,514 by the end of 1954. Thus it appears that of the $84,341,218 to which the court below held cross-petitioners to be entitled, there will be a deficit of $58,599,704, which amount would be confiscated over the period on account of these errors. The proper amount to be set aside each year in order to accumulate the total of $84,341,218 over the 14 years 5 months is $5,100,732. *Thus as a result of these errors there is a confiscation each year of* $3,542,880, the difference between the correct amount and the $1,557,852 actually allowed.

C. *Rate of Return* (pp. 175-215, *supra*).

The Commission fixed the rate of return at 6½% per annum on the rate base erroneously allowed by the Commission. Assuming a proper rate base, it appears from the evidence as a whole, which is not contradicted by substantial evidence, that a reasonable rate of return to cross-petitioners should be not less than 8% per annum. It conclusively appears that the Commission gave no effect to any of the elements entering into a proper rate of return except the one element, cost of capital, and even in its consideration of that element, on the erroneous figures adopted in its opinion, the Commission erred in that it failed by .22% to allow the overall cost to cross-petitioners of recapitalizing their capital assets. The error of the Commission in fixing the rate of return at 6½% per annum of itself manifestly would result in substantial confiscation of cross-petitioners' property and revenues.

D. *Jurisdiction.*

(1) The Present Rates (pp. 145-166, *supra*).

The Commission is without jurisdiction to enter an order reducing cross-petitioners' charges unless and until the

Commission and complainant discharge the burden of proving by substantial evidence that the existing charges are unjust and unreasonable. The Commission and complainant have wholly failed to discharge such burden; and there is no substantial evidence to sustain the finding of the Commission that the existing rates and charges are unjust and unreasonable.

(2) The Failure of the Commission To Fix New Rates (pp. 166-174, *supra*).

Under the Natural Gas Act it is the duty of the Commission, if and when it finds, after hearing, that the existing rates are unjust and unreasonable, (a) to determine just and reasonable charges, and (b) to fix the same by order. The Commission has made no effort to determine just and reasonable charges, has offered no evidence of what just and reasonable charges for cross-petitioners' gas would be for any of the uses to which such gas is subjected, and has entered no order fixing any different charges than those now fixed by the contracts between cross-petitioners and their purchasers. In the present state of the record the Commission has no jurisdiction to enter such an order. The order of the Commission that cross-petitioners file new schedules of rates effecting a reduction in their gross revenues is not a compliance with the mandate of the statute and is not authorized by the terms of the statute.

(3) The Power To Issue an Interim Order (pp. 216-234, *supra*).

The Commission has no power or jurisdiction except that derived from the Natural Gas Act. The Act confers no power or jurisdiction on the Commission to enter an order in the midst of the hearing. The so-called interim order for that reason is void.

(4) The Question of Constitutionality (pp. 234-254, *supra*).

The Natural Gas Act as applied by the Commission to

cross-petitioners and to the business of the latter is in conflict with the due process clause of the Fifth Amendment to the Constitution of the United States; and the interim order purportedly issued under such Act is void.

XIII.

If This Court Should Reverse the Judgment of the Court Below and Uphold the Commission's Order, Cross-Petitioners Should Not Be Required to Refund to Their Customers the Amounts Representing the Ordered Reduction in Revenues Which Have Accrued Since the Commission's Order.

A. *No Public Interest Will Be Served by Requiring Cross-Petitioners To Pay Over as a Windfall to Their Wholesale Customers the Very Substantial Sums of Money Involved in Such a Refund, Which Amounts the Distributing Utilities Contracted To Pay Cross-Petitioners and Which, If Refunded to Them, Such Distributing Utilities Could Not Be Required by State Regulatory Bodies To Pass on to Their Customers, the Consumers.*

B. *The Existing Rates Are Valid and Enforcible Until the Commission Shall Determine the Just and Reasonable Rates and Fix the Same by Order; and Even If the Court Below Should Have Held that the Commission Could Require Cross-Petitioners To File New Schedules of Rates Effecting the Reduction Ordered, Such New Rates Could Not Be Made Retroactive, but Would Become Effective Only When Constituted the New Rates by Order of the Commission.*

(Sec. 10, Summary of Argument, *supra*, p. 67).

The Commission's order (R. Vol. VIII, pp. 3945-6), as amended (R. Vol. VIII, p. 3960), directed cross-petitioners to file new schedules of rates and charges on or before September 1, 1940, which new schedules should reflect a reduction of $3,750,000 per annum in cross-petitioners'

operating revenues. The Commission expressly reserved the right "to reject all or any part of such new schedules and in lieu thereof to prescribe the same by further order" (R. Vol. VIII, p. 3946).

On August 30, 1940, Judge Sparks, one of the judges of the court below, entered a temporary restraining or stay order (R. Vol. VIII, p. 4026). On November 1, 1940, the court below, in proceedings initiated by the Commission and complainant, entered a stay order under Section 19(c) of the Act (15 U. S. C. 717r(c); R. Vol. VIII, pp. 4025-6). As a condition of stay, cross-petitioners were required to file, and did file, with the clerk of the court below their bond in the penal sum of $1,000,000, conditioned on the payment by cross-petitioners to their customers, as their several interests appear, the amounts representing the ordered reduction in revenues accruing pending judicial review, in the event that the Commission's order be sustained. Cross-petitioners urge that, if this Court should disagree with *all* of the contentions of cross-petitioners, and should uphold the order, cross-petitioners should not be required to make refunds to the distributing utilities, which have purchased gas from cross-petitioners under contracts in existence long prior to the enactment of the Act, of the amounts representing the ordered reduction from August, 1940, to the date on which the Commission shall actually fix new rates in lieu of existing charges.

Construing the Natural Gas Act, the Circuit Court of Appeals for the Eighth Circuit, in *Mississippi Fuel Corporation* v. *Federal Power Commission*, 121 Fed. (2) 159, 164 (advance sheet), said:

> "Protection of the ultimate consumer and not the intermediate utility was the manifest purpose of the Act."

Cross-petitioners sell 98% of their gas to distributing utilities, which resell it to the ultimate consumers. The other 2% is sold directly to industrial users at prices not

affected by the order. Only the gas sold to distributing utilities is subject to regulation by the Commission. Section 1(b) of the Act specifies that with respect to sales it applies only

> "to the *sale* in interstate commerce of natural gas *for resale for ultimate public consumption* for domestic, commercial, industrial, or any other use. * * *"

If cross-petitioners be required to refund the difference between the charges which the Commission shall ultimately fix as just and reasonable and the existing charges, the distributing utilities, and not the ultimate customers of those utilities, will benefit. It may be that the new schedule of rates will effect such savings in the cost to the distributing utilities as that under all the facts they might be required to pass the saving under the new rates on to their ultimate customers from and after the time when the state regulatory bodies having jurisdiction of the retail rates should order a reduction; but the amounts received in the meantime by the respective utility distributing companies, from a refund by cross-petitioners of amounts representing the accrued reductions, could not be considered by the regulatory bodies in fixing future retail rates for the sale of gas. The principle that future rates can not be based on past profits or losses is well established. *Knoxville* v. *Knoxville Water Co.*, 212 U. S. 1, 14; *Galveston Electric Co.* v. *Galveston*, 258 U. S. 388, 395; *City of Minneapolis* v. *Rand*, 285 Fed. 818, 823. In the latter case the court thus aptly stated the principle:

> "The claim that past profits justify a present rate that is not reasonable is no more tenable than the converse contention that if a public service corporation has operated at a loss in prior years it is therefore entitled to more than a reasonable rate of return in order to make up the deficits."

In any rate proceeding that may arise after the Commission finally fixes new rates and charges at which cross-petitioner may sell their gas, the refunds covering gas sold

prior to that time would fall in the category of past profits, and thus could not enter into the rate fixed for future retail sales. The utility distributing companies purchasing gas from cross-petitioners are not entitled to a windfall through which they would receive back from cross-petitioners substantial sums of money paid to cross-petitioners in pursuance of contracts voluntarily negotiated with cross-petitioners long prior to the enactment of the Natural Gas Act. As between cross-petitioners, which have collected only those sums which the distributing utilities contracted to pay for gas, and the distributing utilities, which have contracted to pay the money, cross-petitioners are clearly entitled to retain the sum representing the ordered reduction up until the time when new rates shall have been actually established by order of the Commission.

On the matter of refunds, in rate cases, the courts are guided by equitable principles in making disposition of the fund. In *U. S.* v. *Morgan*, 307 U. S. 183, 190-1, this Court, in a decision concerning the disposition of moneys paid into court in a rate case, stated "two cardinal principles." One of these cardinal principles is that a court

> "in exerting its extraordinary powers to stay execution of a rate order and in directing payment into court of so much of the rate as has been found administratively to be excessive, it assumes the duty of making disposition of the fun in conformity to equitable principles."

We submit that in equity there is no basis for taking out of the pockets of cross-petitioners revenues that have accrued from the sale of gas under contracts voluntarily executed by the purchasing utilities and transferring this money to the pockets of the distributing utilities, thus enriching the utilities at the expense of cross-petitioners, with no benefit whatever accruing to the ultimate consumers of the utilities, for the protection of whose interests the legislation was enacted. No public interest would be served by thus penalizing cross-petitioners.

There is another sound legal basis for the contention that no such refund should be required of cross-petitioners. In Subdivision V of this brief (*supra*, pp. 166-174) we have pointed out that the existing rates are presumed to be just and reasonable and must be continued in effect until superseded by new rates established by constitutional administrative procedure. *C. I. & L. Ry. Co.* v. *International Milling Co.*, 43 Fed. (2nd) 93, 96. The order of the Commission directing cross-petitioners to file new schedules of rates effective retroactively as to all bills regularly rendered on or after September 1, 1940, which in practical effect means that the new rates shall affect all gas sold on or after August 1, 1940, does not fix new rates. As above pointed out, the Commission expressly reserved the right to reject the new rates or any of them and to fix new rates for those rejected by further order. If it is conceivable that the Commission, in violation of the plain mandate of the statute, can require cross-petitioners to submit a new schedule of rates, all of which the Commission must examine and any or all of which it may reject or approve, we submit that the rates tendered by cross-petitioners do not supersede the existing rates until such time as the Commission shall have examined and approved them. It is equally clear that the new rates would be effective only from and after the time of the approval. They cannot be made retroactive to August 1, 1940. It follows, of course, that up to the time of the approval of the new rates the purchasing utilities should pay for the gas purchased from cross-petitioners at the prices fixed by their contracts.

Conclusion.

For each of the reasons above reviewed the interim order of the Commission is void and should be set aside, and for the same reasons the order of the Commission manifestly would operate to confiscate cross-petitioners' property and revenues to the amount of $3,750,000 each year.

Cross-petitioners respectfully submit that, upon the grounds discussed and upon each of said grounds, the judgment of the court below that the order of the Commission be vacated should be in all things affirmed, and that this Court should direct that this cause be remanded to the Commission with directions that it be dismissed. In the alternative, cross-petitioners respectfully submit that, in the event the order of the Commission be upheld, this Court should decree that the existing rates shall continue in operation and effect to the date on which the Commission shall have determined just and reasonable rates and fixed the same by order.

GEORGE I. HAIGHT,
209 South LaSalle St.,
Chicago, Ill.,
J. J. HEDRICK,
20 North Wacker Drive,
Chicago, Ill.,
WILLIAM E. LUCAS,
209 South LaSalle St.,
Chicago, Ill.,
S. A. L. Morgan
20 North Wacker Drive,
Chicago, Ill.,
Attorneys for Cross-Petitioners, Natural Gas Pipeline Company of America and Texoma Natural Gas Company.

HAIGHT, GOLDSTEIN & HOBBS,
209 South LaSalle St.,
Chicago, Ill.,

MORGAN, CULTON, MORGAN & BRITAIN,
Amarillo, Texas,
Of Counsel.

APPENDIX A.

PERTINENT SECTIONS OF THE NATURAL GAS ACT. (15 U. S. C. 717.)

SECTION 1. (15 U. S. C. 717.) (a) As disclosed in reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

(b) The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

SECTION 4. (15 U. S. C. 717c.) (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file

with the Commission, within such time (not less than sixty days from the date this Act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, or State commission, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect: *'Provided,* That the Commission shall not have authority to suspend the rate, charge, classification, or service for the sale of natural gas for resale for industrial use only; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make

such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

SECTION 5. (15 U. S. C. 717d.) (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however*, That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

SECTION 7. (15 U. S. C. 717f.) (a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: *Provided*, That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers.

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

(c) No natural-gas company shall undertake the construction or extension of any facilities for the transportation of natural gas to a market in which natural gas is already being served by another natural-gas company, or acquire or operate any such facilities or extensions thereof, or engage in transportation by means of any new or additional facilities, or sell natural gas in any such market, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require such new construction or operation of any such facilities or extensions thereof: *Provided, however*, That a natural-gas company already serving a market may enlarge or extend its facilities for the purpose of supplying increased market demands in the territory in which it operates. Whenever any natural-gas company shall make application for a certificate of convenience and necessity under the provisions

of this subsection, the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission. In passing on applications for certificates of convenience and necessity, the Commission shall give due consideration to the applicant's ability to render and maintain adequate service at rates lower than those prevailing in the territory to be served, it being the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate public consumption for domestic, commercial, industrial, or any other use at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest.

SECTION 19. (15 U. S. C. 717r.) (a) Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this Act to which such person, State, municipality, or State commission is a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon.

(b) Any party to a proceeding under this Act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the circuit court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the

filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

(c) The filing of an application for rehearing under subsection (a) shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

SECTION 20. (15 U. S. C. 717s.) (a) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this Act, or of any rule, regulation, or order thereunder, it may in its discretion bring an action in the proper district court of the United States, the District Court of the United States for the District of Columbia, or the United States courts of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or prac-

tices and to enforce compliance with this Act or any rule, regulation, or order thereunder, and upon a proper showing a permanent or temporary injunction or decree or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices or concerning apparent violations of the Federal antitrust laws to the Attorney General, who, in his discretion, may institute the necessary criminal proceedings.

(b) Upon application of the Commission the district courts of the United States, the District Court of the United States for the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction to issue writs of mandamus commanding any person to comply with the provisions of this Act or any rule, regulation, or order of the Commission thereunder.

SECTION 21. (15 U. S. C. 717t.) (a) Any person who willfully and knowingly does or causes or suffers to be done any act, matter, or thing in this Act prohibited or declared to be unlawful, or who willfully and knowingly omits or fails to do any act, matter, or thing in this Act required to be done, or willfully and knowingly causes or suffers such omission or failure, shall, upon conviction thereof, be punished by a fine of not more than $5,000 or by imprisonment for not more than two years, or both.

(b) Any person who willfully and knowingly violates any rule, regulation, restriction, condition, or order made or imposed by the Commission under authority of this Act, shall, in addition to any other penalties provided by law, be punished upon conviction thereof by a fine of not exceeding $500 for each and every day during which such offense occurs.

APPENDIX B.

Summary Sheet of Exhibit 140.

EXHIBIT 140

NATURAL GAS PIPELINE COMPANY OF AMERICA AND TEXOMA NATURAL G COMPANY

(Combined)

Earnings Statement Covering Entire Life of Project

Line No.		Total 1932–1938 Inclusive	Total 1939–1954 Inclusive	Total 1932–1954 Inclusive	Avera 1932-1 Inclu
	Revenue				
1	From Domestic Sales	$59,480,464	$164,835,603	$224,316,067	$ 9,7
2	From Industrial Sales	14,781,390	46,190,085	60,971,475	2,6
3	From Texoma Field Sales	145,358	256,591	401,949	1
4	Total Gas Sales	$74,407,212	$211,282,279	$285,689,491	$12,4
5	From Gasoline Sales	3,764,769	8,974,017	12,738,786	5
6	From Other Operating Income	113,563	193,531	307,094	1
7	Total Revenue	$78,285,544	$220,449,827	$298,735,371	$12,9
	Operation, Maintenance and Retirement Expense				
8	Operation Expense	$24,053,765	$ 80,994,386	$105,048,151	$ 4,5
9	Company Used Gas (Deduct)	1,730,164	6,272,871	8,003,035	3
10	Maintenance Expenses	2,514,019	13,785,303	16,299,322	7
11	Expense of Retiring Property	42,832	109,449	152,281	
12	Maintenance Contingencies (10%)	—	1,389,473	1,389,473	6
13	Net Operation, Maintenance and Retirement Expense	$24,880,452	$ 90,005,740	$114,886,192	$ 4,9
14	Revenue Remaining for Amortization and Return	$53,405,092	$130,444,087	$183,849,179	$ 7,9
15	Capital Expenditure Excluding Cost of Gas Reserves	$50,305,248	$ 11,900,174	$ 62,205,422	$
16	Replacement Contingencies (10%)	—	256,406	256,406	
17	Cost of Gas Reserves	15,893,513	2,800	15,896,313	
18	Working Capital	975,000	—	975,000	
19	Total Capital Expenditure and Working Capital	$67,173,761	$ 12,159,380	$ 79,333,141	$71,7
20	Liquidating Salvage Value of				
21	(a) Capital Expenditures	—	—	457,452	
22	(b) Warehouse Stocks	—	—	24,314	
23	(c) Working Capital Cash	—	—	567,366	
24	Total Liquidating Salvage Value	—	—	$ 1,049,132	
25	Total Capital Expenditure and Working Capital Less Total Liquidating Salvage Value (Total Amortization)	—	—	78,284,009	$ 3,4
26	Revenue Remaining for Return	—	—	105,565,170	4,5
27	Average Rate of Return	—	—	—	6

APPENDIX C.

EXHIBIT 210.

(Revision of Pg. 1, Exhibit 141) Federal Power Commission. Docket No.
Exhibit No. 210 (For Identification)

Natural Gas Pipeline Company of America and Texoma Natural Gas Company
(Combined)

Earnings Statement Based on Book Cost as of January 1, 1939.

Line Number	As of Jan. 1, 1939	Total 1938–1954	Average 1939–1954
Revenue			
From Domestic Sales	—	$164,835,603	$10,302,225
From Industrial Sales	—	46,190,085	2,886,880
From Texoma Field Sales	—	256,591	16,037
Total Gas Sales	—	$211,282,279	$13,205,142
From Gasoline Sales	—	8,974,017	560,876
From Other Operating Income	—	193,531	12,096
Total Revenue	—	$220,449,827	$13,778,114
Operation and Maintenance			
Operation Expenses	—	$ 80,994,386	$ 5,062,149
Company Used Gas (deduct)	—	6,272,871	392,054
Maintenance Expense	—	13,785,303	861,581
Maintenance Contingencies (10%)	—	1,378,533	86,158
Net Operation and Maintenance	—	$ 89,885,351	$ 5,617,834
Revenue Remaining for Replacements, Amortization and Return	—	$130,564,476	$ 8,160,280
Reserve for Replacements			
Capital Expenditure for Replacements	—	$ 3,105,244	$ 194,078
Cost of Retiring Capital Replaced	—	109,449	6,841
Salvage Value of Retirements (deduct)	—	541,253	33,828
Replacement Contingencies (10%)	—	267,346	16,709
Total of Reserve for Replacements	—	$ 2,940,786	$ 183,800
Capital Expenditures per Books, excluding Gas Reserves	$ 49,830,479		
Viewed Depreciation (deduct)	2,485,079		
Cost of Gas Reserves less Depletion to January 1, 1939	12,402,884		
Cost of Additional Property	—	$ 9,338,988	—
Going Concern Value	8,500,000	—	—
Working Capital	975,000	—	—
Total	69,223,284	$ 78,562,267	—
Total Rate Base	—	—	$75,305,459
Liquidating Salvage Value of			
(a) Capital Expenditure	—	$ 457,452	
(b) Warehouse Stocks	—	24,314	—
(c) Working Capital Cash	—	567,366	—
Total Liquidating Salvage Value	—	$ 1,049,132	—
Total to be Amortized	—	$ 77,513,135	—
Amortization Allowance (Sinking fund, 2% interest compounded semi-annually)	—	66,152,816	$ 4,134,551
Revenue Remaining for Return	—	61,470,874	$ 3,841,929
Rate of Return			5.10%

Federal Power Commission
Docket No. G-109 & G-112
Hearing Exhibit No. 210

APPENDIX D.

EXHIBIT 211.

2820 Revision of p. 1 of Ex. 142

Federal Power Commission. Docket No.
Exhibit No. 211 (For Identification)

Federal Power Commission
Docket No. G-109 & G-112
Hearing Ex. No. 211

Natural Gas Pipeline Company of America and Texoma Natural Gas Company
(Combined)

Earnings Statement Based on Reproduction Cost New
Less Existing Depreciation as of June 1, 1939

Line Number		As of June 1, 1939	Total 6-1-39 to 12-31-54 Inclusive	Average Yearly 6-1-39 to 12-31-54 Inclusive
	Revenue			
1	From Domestic Sales		$160,370,063	$10,291,1
2	From Industrial Sales		44,811,352	2,875,5
3	From Texoma Field Sales		247,567	15,8
4	Total Gas Sales		$205,428,982	$13,182,6
5	From Gasoline Sales		8,698,468	558,1
6	From Other Operating Income		190,161	12,2
7	Total Revenue		214,317,611	$13,753,0
	Operation and Maintenance			
8	Operation Expense		$ 79,054,616	$ 5,073,0
9	Company Used Gas (deduct)		6,107,808	391,9
10	Maintenance Expense		13,536,094	868,0
11	Maintenance Contingencies (10%)		1,353,603	86,8
12	Net Operation and Maintenance		$ 87,836,415	5,636,3
13	Revenue Remaining for Replacement, Amortization and Return		$126,481,196	$ 8,116,4
	Reserve for Replacements			
14	Capital Expenditure for Replacements		$ 3,086,671	$ 198,0
15	Cost of Retiring Capital Replaced		109,063	6,9
16	Salvage Value of Retirement (deduct)		531,642	34,1
17	Replacement Contingencies (10%)		266,411	17,0
18	Total of Reserve for Replacements		$ 2,930,503	$ 188,0
19	Reproduction Cost New Excluding Gas Reserves	$ 56,302,250	$ —	$ —
20	Viewed Depreciation (deduct)	2,866,758	—	—
21	Value of Gas Reserves	13,334,775	—	—
22	Cost of Additional Property	—	$ 9,145,083	—
23	Going Concern Value	8,500,000	—	—
24	Working Capital	975,000	—	—
25	Total	$ 76,245,267	$ 85,390,350	—
26	Total Rate Base	—	—	$82,291,5
27	Liquidating Salvage Value of			
28	(a) Capital Expenditure	—	$ 457,452	—
29	(b) Warehouse Stocks	—	24,314	—
30	(c) Working Capital Cash	—	567,363	—
31	Total Liquidating Salv. Value	—	$ 1,049,132	—
32	Total to be Amortized		$ 84,341,218	$ —
33	Amortization Allowance (Sinking fund, 2% interest compounded semi-annually)	—	$ 72,304,635	$ 4,639,9
34	Revenue Remaining for Return	—	$ 51,246,058	$ 2,288,1
35	Rate of Return			4.0